PHOENIX TECHNOLOGIES LTD
Form 10-K
November 15, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT
PURSUANT TO SECTIONS 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
for the fiscal year ended September 30, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
for the transition period to .

Commission file number 0-17111

PHOENIX TECHNOLOGIES LTD.
(Exact name of registrant as specified in its charter)

Delaware	**04-2685985**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

915 Murphy Ranch Road, Milpitas, CA 95035
(Address of principal executive offices, including zip code)

(408) 570-1000
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:
Common Stock, par value $.001
Preferred Stock Purchase Rights
(Title of each Class)

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES o NO þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES o NO þ

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES þ NO o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO þ

The aggregate market value of the registrant s Common Stock held by non-affiliates of the registrant as of March 30, 2007 was $116,700,700 based upon the last reported sales price of the registrant s Common Stock on the NASDAQ Global Market on such date. For purpose of this disclosure, shares of Common Stock held by directors and officers of the registrant and by stockholders who own more than 5% of the registrant s outstanding Common Stock have been excluded because such persons may be deemed affiliates of the registrant. This determination is not necessarily a conclusive determination for other purposes.

The number of shares of the registrant s Common Stock outstanding as of November 9, 2007 was 27,119,464.

Documents Incorporated by Reference

Portions of the registrant s definitive proxy statement to be filed pursuant to Regulation 14A in connection with the 2007 annual meeting of its stockholders are incorporated by reference into Part III of this Form 10-K.

PHOENIX TECHNOLOGIES LTD.

FORM 10-K
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FORWARD-LOOKING STATEMENTS

This report on Form 10-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements may include, but are not limited to, statements concerning future liquidity and financing requirements, potential price erosion, plans to make acquisitions, dispositions or strategic investments, expectations of sales volume to customers and future revenue growth, plans to improve and enhance existing products, plans to develop and market new products, trends we anticipate in the industries and economies in which we operate, the outcome of pending disputes and litigation, and other information that is not historical information. Words such as could , expects , may , anticipate believes , projects , estimates , intends , plans , and other similar expressions are intended to indicate forward-looki statements. All forward-looking statements included in this report reflect our current expectations and various assumptions, and are based upon information available to us as of the date hereof. Our expectations, beliefs and projections are expressed in good faith, and we believe there is a reasonable basis for them, but we cannot assure you that our expectations, beliefs and projections will be realized.

Some of the factors that could cause actual results to differ materially from the forward-looking statements in this Form 10-K include the factors described in the section of this Form 10-K entitled Item 1A-Risk Factors. These factors include, but are not limited to: our dependence on key customers; our ability to successfully enhance existing products and develop and market new products and technologies; whether and when we will be able to return to profitability; our ability to meet our capital requirements in the long-term and maintain positive cash flow from operations; our ability to attract and retain key personnel; product and price competition in our industry and the markets in which we operate; our ability to successfully compete in new markets where we do not have significant prior experience; end-user demand for products incorporating our products; the ability of our customers to introduce and market new products that incorporate our products; risks associated with any acquisition strategy that we might employ; results of litigation; failure to protect our intellectual property rights; changes in our relationship with leading software and semiconductor companies; the rate of adoption of new operating system and microprocessor design technology; the volatility of our stock price; risks associated with our international sales and operating internationally, including currency fluctuations, acts of war or terrorism, and changes in laws and regulations relating to our employees in international locations; whether future restructurings become necessary; our ability to complete the transition from our historical reliance on paid-up licenses to volume purchase license agreements (VPAs) and pay-as-you-go arrangements; any material weakness in our internal controls over financial reporting; changes in financial accounting standards and our cost of compliance; the effects of any software viruses or other breaches of our network security, power shortages and unexpected natural disasters; trends regarding the use of the x86 microprocessor architecture for personal computers and other digital devices; and changes in our effective tax rates. If any of these risks or uncertainties materialize, or if any of our underlying assumptions are incorrect, our actual results may differ significantly from the results that we express in or imply by any of our forward-looking statements. We do not undertake any obligation to revise these forward-looking statements to reflect future events or circumstances.

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PART I

ITEM 1. *BUSINESS*

Description of Business

Phoenix Technologies Ltd. (Phoenix or the Company) designs, develops and supports core system software for personal computers and other computing devices. Our products, which are commonly referred to as firmware, support and enable the compatibility, connectivity, security and manageability of the various components and technologies used in such devices. We sell these products primarily to computer and component device manufacturers. We also provide training, consulting, maintenance and engineering services to our customers.

The majority of the Company s revenue comes from Core System Software (CSS), the modern form of BIOS (Basic Input-Output System) for personal computers, servers and embedded devices. Our CSS customers are primarily original equipment manufacturers (OEMs) and original design manufacturers (ODMs), who incorporate CSS products during the manufacturing process. The CSS is typically stored in non-volatile memory on a chip that resides on the motherboard built into the device manufactured by our customer. The CSS is executed during the power-up process in order to test, initialize and manage the functionality of the device s hardware. We believe that our products are incorporated into over 125 million computing devices each year, making us the global market share leader in the CSS sector.

The Company also designs, develops and supports software products and services that provide the users of personal computers with enhanced device utility, reliability and security. Included among these products and services are offerings which assist users to locate and manage portable devices that have been lost or stolen and offerings which enable certain applications to operate on the device independently of the device s primary operating system. Although the true consumers of these products and services are enterprises, governments, service providers and individuals, we typically license these products to OEMs and ODMs to assist them in making their products attractive to those end-users.

The Company derives additional revenue from providing development tools and support services such as customization, training, maintenance and technical support to our software customers and to various development partners.

The Company was incorporated in the Commonwealth of Massachusetts in September 1979, and was reincorporated in the State of Delaware in December 1986. The Company s headquarters is in Milpitas, California. The mailing address of our headquarters is 915 Murphy Ranch Road, Milpitas, CA 95035, the telephone number at that location is +1 (408) 570-1000 and the Company s website is www.phoenix.com.

Products

Described below are certain selected products sold by the Company.

Phoenix Core Systems Software (CSS)

Phoenix s CSS products include:

Phoenix SecureCore

Phoenix SecureCore™ is our primary CSS product, and consists of the firmware that, together with its predecessor TrustedCore, runs many of today s most modern computers. SecureCore supports and enables the compatibility, connectivity, security and manageability of the various components of modern desktop and notebook PCs, PC-based servers and embedded computing systems. The SecureCore product group was released during fiscal year 2007 and includes support for a wide variety of new features developed by semiconductor manufacturers who provide products to the PC industry.

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Phoenix TrustedCore

Phoenix TrustedCore™ is the predecessor to SecureCore and was the leading product from our CSS product group until the launch of SecureCore during fiscal year 2007. Customers can continue to purchase TrustedCore object licenses and source code to support older silicon versions in their new and existing products.

Phoenix Award

The Phoenix Award CSS product group supports fast time to market for high volume PC and digital device electronics design and manufacturing companies. Typically these manufacturers operate on short design and product life cycles. The Phoenix Award product group delivers the standards-based features, simplicity and small code size necessary for this dynamic market segment. Our Phoenix Award CSS product group consists of both our AwardCore™ CSS product group and our legacy Award BIOS™ product group. Our customers can continue to purchase Award BIOS object licenses and source code to support older silicon versions in their new and existing products.

Developments in Core System Software

In recent years, the personal computing industry has been migrating to a new overall design concept for the standardization of Core System Software. This standardization concept was initially pioneered by Intel with its Extensible Firmware Interface (EFI), created for CSS support of the Itanium processor, and the Platform Innovation Framework. Intel s initial implementation of EFI has continued to evolve in recent years and this overall design concept is now supported by a wide industry consortium called the Unified EFI Forum, Inc., which includes Microsoft, Intel, AMD, Phoenix and others. Under this design concept, firmware has become more modular and standardized than it had been in the past. As a result, computer silicon providers are now able to deliver hardware drivers that can be easily integrated into the CSS by both independent BIOS vendors and computer OEM s and ODM s. In addition, due to the standardization of the interfaces, individual developers can also build add-ons or plug-ins to standard interface specifications and deliver products that may be incorporated with firmware platforms from a variety of vendors. Vendor support of these new design concepts and industry standards eases the burden of continually porting features and customizations to new hardware and personal computer designs.

The current Phoenix SecureCore architecture incorporates these philosophies, and hence supports various device drivers and value-added service offerings known as add-ons and plug-ins that we and others may sell in the future.

Phoenix New Products

Phoenix FailSafe Solution

The Phoenix FailSafe™ solution is an advanced theft-loss protection and prevention solution for mobile PCs. The FailSafe solution consists of an embedded tamper-resistant agent that resides in the mobile device and a network connected secure communications center (SCC). The SCC enables users to set policies for their mobile devices and then monitors those devices to detect and prevent violations of those policies. Optional features of this product include the ability for users to encrypt data on the mobile device as well as to retrieve or remove information from the device remotely. This product and the related service offering were developed by Phoenix during fiscal year 2007, and were officially launched in October 2007, so have yet to produce revenue for the Company.

Phoenix HyperSpace

The Phoenix HyperSpace™ family of products provides an environment that enables various Phoenix and third party applications to be installed on a device and to operate independently from the user s primary operating system. A

primary component of this family is a lightweight virtualization engine called Phoenix HyperCore™, which allows multiple purpose-built applications to operate autonomously alongside the primary operating system. With HyperCore these applications can run at any time, before the primary operating system has been loaded, while it is running or after it has shut down, and users can instantaneously switch between their primary operating system and the HyperSpace environment with a single button or mouse click. Within the HyperSpace environment a

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specialized kernel provides services, management and security for the purpose-built applications. This product family was developed by Phoenix during fiscal year 2007, and was officially launched in November 2007, so has yet to produce revenue for the Company.

Sales and Marketing

The Company sells its products and services through a global direct sales force with sales offices in North America, Japan and the Asia Pacific region, as well as through a network of regional distributors and sales representatives. We market to OEMs, ODMs, resellers, system integrators, and system builders as well as to independent software vendors.

Our products and services are sold directly to larger OEMs and ODMs of PCs and of embedded systems, many of which are global technology leaders. These include*:*

Original Equipment Manufacturers

Dell Inc.	International Business Machines Corporation	Samsung Electronics Co. Ltd.
Foxconn Electronics Inc.	LG Electronics Inc.	Sharp Corporation
Fujitsu Ltd.	Lenovo (Singapore) Pte. Ltd.	Sony Corporation
Fujitsu Siemens Computers GmbH	Matsushita Electric Industrial Co., Ltd.	Toshiba Corporation
Hewlett-Packard Company	NEC Corporation	

Original Design Manufacturers	Motherboard Manufacturers	Non-PC Systems
Arima Computer Corporation	ASUSTeK Computer Inc.	Motorola, Inc.
Compal Electronics Inc.	Elitegroup Computer Systems Co., Inc.	NEC Corporation
Inventec Corporation	Giga-byte Technology Co., Ltd.	Taito Corporation
Quanta Computer, Inc.	Micro-Star International Co., Ltd.	
Wistron Corporation		

Significant Customers

Quanta Computer, Inc. accounted for 18% of the Company s total revenues in fiscal year 2007. Fujitsu Ltd. accounted for 12% of the Company s total revenues in fiscal year 2006. Lenovo (Singapore) Pte. Ltd. and Quanta Computer, Inc. accounted for 15% and 12%, respectively, of the Company s total revenues in fiscal year 2005. No other customer accounted for more than 10% of total revenues in fiscal years 2007, 2006 or 2005.

International Sales and Activities

Revenues derived from international sales comprise a majority of total revenues. During fiscal years 2007, 2006 and 2005, $39.4 million, or 84%, $54.1 million, or 89%, and $74.7 million, or 75%, of total revenues for each of the respective years were derived from sales outside of the U.S. See Note 8 to the Consolidated Financial Statements for information relating to revenues by geographic area. We have international sales and engineering offices in Japan, Korea, Taiwan, China and India. Almost all of our license fees and royalty contracts are U.S. dollar denominated; however, we do enter into non-recurring engineering (NRE) service contracts in Japan in the local currency.

In addition, an increasing percentage of our labor force, particularly in engineering, is located in China, Taiwan and India. Approximately 71%, or 237, of our employees are located outside of the U.S. as of September 30, 2007.

Competition

The Company competes for sales primarily with in-house research and development (R&D) departments of PC and component manufacturers such as Dell, Hewlett Packard, Toshiba and Intel. These manufacturers may have significantly greater financial and technical resources, as well as closer engineering ties and experience with specific hardware platforms, than we do. We believe that OEM and ODM customers often license our CSS products rather than develop these products internally in order to: (1) differentiate their system offerings with advanced features; (2) easily leverage the additional value of our other software solutions; (3) improve time to market;

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(4) reduce product development risks; (5) minimize product development and support costs; and/or (6) enhance compatibility with the latest industry standards.

The Company also competes for sales with other independent suppliers, including American Megatrends Inc., a privately held U.S. company, and Insyde Software Corp., a public company based and listed in Taiwan.

Product Development

The Company constantly seeks to develop new products, maintain and enhance our current product lines, maintain technological competitiveness and meet continually changing customer and market requirements. Our research and development expenditures in fiscal years 2007, 2006 and 2005 were $19.2 million, $22.9 million and $20.4 million, respectively. All of our expenditures for research and development have been expensed as incurred. As of September 30, 2007, the Company s research and development and customer engineering group included 246 full-time employees, or 74%, of our total workforce.

Intellectual Property and Other Proprietary Rights

The Company relies primarily on U.S. and foreign patents, trade secrets, trademarks, copyrights and contractual agreements to establish and maintain proprietary rights in our technology. We have an active program to file applications for and obtain patents in the U.S. and in selected foreign countries where there is a potential market for our products. As of September 30, 2007, we have been issued 79 patents in the U.S. and have 38 patent applications in process in the U.S. Patent and Trademark Office. On a worldwide basis, we have been issued 155 patents with respect to our product offerings and have 137 patent applications pending with respect to certain products we market. We also hold certain licenses and other rights granted to us by the owners of other patents. There can be no assurance that any of these patents would be upheld as valid if challenged. Of the key patents and copyrights that are most closely tied to our product offerings, none are set to expire within the next eight years.

The Company s general policy has been to seek patent protection for those inventions and improvements likely to be incorporated in our products or otherwise expected to be of long-term value. We protect the source code of our products as trade secrets and as unpublished copyrighted works. We may also initiate litigation where appropriate to protect our rights in that intellectual property. We license the source code for our products to our customers for limited uses. Wide dissemination of our software products makes protection of our proprietary rights difficult, particularly outside the United States. Although it is possible for competitors or users to make illegal copies of our products, we believe the rate of technology change and the continual addition of new product features lessen the impact of illegal copying.

In recent years, there has been a marked increase in the number of patents applied for and issued with respect to software products. Although we believe that our products do not infringe on any patents, copyright or other proprietary rights of third parties, we have no assurance that third parties will not obtain, or do not have, intellectual property rights covering features of our products, in which event we or our customers might be required to obtain licenses to use such features. If an intellectual property rights holder refuses to grant a license on reasonable terms or at all, we may be required to alter certain products or stop marketing them.

Compliance with Environmental Regulations

The Company s compliance with federal, state and local provisions enacted or adopted for protection of the environment has had no material effect upon our capital expenditures, earnings or competitive position.

Employees

As of September 30, 2007, we employed 334 full-time employees worldwide, of whom 246 were in research and development and customer engineering, 35 were in sales and marketing, and 53 were in general administration. Other than in Nanjing, China, where our employees have formed a trade union in accordance with local laws and regulations, our employees are not represented by any labor organizations. We have never experienced a work stoppage and we consider our employee relations to be satisfactory.

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Executive Officers of the Company

The executive officers of the Company serve at the discretion of the Board of Directors of the Company. As of the filing date of this Form 10-K, the executive officers of the Company are as follows:

Name	Age	Position
Woodson M. Hobbs	60	President and Chief Executive Officer
Richard W. Arnold	59	Chief Operating Officer and Chief Financial Officer
Dr. Gaurav Banga	35	Senior Vice President, Engineering and Chief Technology Officer
David L. Gibbs	50	Senior Vice President and General Manager, Worldwide Field Operations
Timothy C. Chu	34	Vice President, General Counsel and Secretary

BIOGRAPHIES

Mr. Hobbs joined the Company as President and Chief Executive Officer and as a member of the Board of Directors of the Company in September 2006. Prior to joining the Company, Mr. Hobbs served as president, chief executive officer and a member of the board of Intellisync Corporation, a provider of platform-independent wireless messaging and mobile software, from 2002 to 2006. Between 1995 and 2002, Mr. Hobbs was a consulting executive for the venture capital community and a strategic systems consultant to large corporations. During this timeframe, he held the position of interim chief executive officer for various periods at the following companies: FaceTime Communications, a provider of instant messaging network-independent business solutions; Tradenable, Inc., an online escrow service company; BigBook, Inc., a provider in the online yellow pages industry; and I/PRO Corporation, a provider of quantitative measurement of Web site usage. From 1993 to 1994, Mr. Hobbs served as chief executive officer of Tesseract Corporation, a human resources outsourcing and software company. Mr. Hobbs spent the early part of his career with Charles Schwab Corporation, a securities brokerage and financial services company, as chief information officer; with Service Bureau, a division of IBM, as a developer; and with Online Focus, an online credit union system, as the director of operations.

Mr. Arnold joined the Company as Executive Vice President, Strategy and Corporate Development in September 2006 and was also appointed Chief Financial Officer in November 2006. In October 2007, Mr. Arnold was named Chief Operating Officer and Chief Financial Officer. Prior to joining the Company, Mr. Arnold served as a member of the board of the Intellisync Corporation from 2004 to 2006. From 2001 to 2006, Mr. Arnold served as a founding partner of Committed Capital Proprietary Limited, a private equity investment company based in Sydney, Australia. From 1999 to 2001, Mr. Arnold served as executive director of Consolidated Press Holdings Limited, also a private investment company based in Sydney. Mr. Arnold has also previously served as managing director of TD Waterhouse Australia, a securities dealer; as chief executive officer of Integrated Decisions and Systems, Inc., an application software company; as managing director of Eagleroo Proprietary Limited, a corporate advisory company; and in various capacities with Charles Schwab Corporation, a securities brokerage and financial services company, including serving as chief financial officer and as executive vice president strategy and corporate development. Mr. Arnold holds a B.S. degree in psychology from Stanford University.

Dr. Banga joined the Company as Chief Technology Officer in October 2006 and was appointed Senior Vice President, Engineering in November 2006. Prior to joining the Company, he was vice president of product management at Intellisync (and at Nokia Corp., after its acquisition of Intellisync), responsible for all client-side products. Before Intellisync, Dr. Banga was co-founder and chief executive officer of PDAapps, the creator of

VeriChat, a mobile instant messaging solution. PDAapps was acquired by Intellisync in 2005. From 1998 to 2005, Dr. Banga was a senior engineer at Network Appliance. Dr. Banga holds a B.Tech. in computer science and engineering from the Indian Institute of Technology, Delhi, as well as M.S. and Ph.D. degrees in computer science from Rice University.

Mr. Gibbs joined the Company as Vice President of Business Development in March 2001, was promoted to Senior Vice President and General Manager of the Information Appliance Division in May 2001, became Senior Vice President and General Manager of the Global Sales and Support Division in October 2001, and then became

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Senior Vice President and General Manager, Worldwide Field Operations in October 2005. From 1998 to 2001, Mr. Gibbs served as vice president, sales and Asia Pacific strategic accounts manager at FlashPoint Technologies, a company that provides embedded software solutions. From 1997 to 1998, Mr. Gibbs was vice president of sales at DocuMagix, Inc. Mr. Gibbs held a number of executive sales and business development positions with Insignia Solutions from 1993 to 1997. Mr. Gibbs holds a bachelor s degree in economics from the University of California at Los Angeles.

Mr. Chu joined the Company as Vice President, General Counsel and Secretary in April 2007. Prior to joining the Company, from 2004 to 2007, Mr. Chu served as director of corporate legal affairs at Solectron Corporation, a leading global provider of supply chain and electronics manufacturing solutions, and as senior corporate counsel from 2003 to 2004. From 1999 to 2003, Mr. Chu was an attorney and then a senior attorney at Venture Law Group, a Silicon Valley law firm. From 1997 to 1999, Mr. Chu was an associate in the New York and Helsinki offices of White & Case LLP, an international law firm. Mr. Chu received his B.A. degree in Economics and Chinese Language and Literature from the University of Michigan and his J.D. degree from the University of Michigan Law School.

Available Information

The Company s website is located at www.phoenix.com. Through a link on the Investor Relations section of our website, we make available the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: the Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. All such filings are available free of charge. Also available on our website are printable versions of our Corporate Governance Guidelines, Audit Committee charter, Compensation Committee charter, Nominating and Corporate Governance Committee charter, Insider Trading Policy and Code of Ethics. Information accessible through our website does not constitute a part of, and is not incorporated into, this annual report on Form 10-K or into any of our other filings with the Securities and Exchange Commission. Copies of the Company s fiscal year 2007 Annual Report on Form 10-K may also be obtained without charge by contacting Investor Relations, Phoenix Technologies Ltd., 915 Murphy Ranch Road, Milpitas, California, 95035 or by calling 408-570-1319.

ITEM 1A. *RISK FACTORS*

The following factors should be considered carefully when evaluating our business.

Dependence on Key Customers

Most of our revenues come from a relatively small number of customers, comprised of larger OEMs, ODMs and computer equipment manufacturers. Our ten largest customers accounted for approximately 65%, 57% and 62% of net revenue in fiscal years 2007, 2006 and 2005, respectively. The loss of any key customer and our inability to replace revenues provided by a key customer may have a material adverse effect on our business and financial condition. If these customers fail to meet guaranteed minimum royalty payments and other payment obligations under existing agreements, our operating results and financial condition could be adversely affected.

Our key customers and other potential larger customers enter into agreements for the purchase of large quantities of our licensed products. As such they may be able to negotiate terms in such agreements which are favorable to them and may impose risks and burdens on us that are greater than those we have historically been exposed to, including those related to indemnification and warranty provisions. These risks may become more pronounced if a larger portion of our revenue is generated from agreements directly with larger computer equipment manufacturers rather than through indirect channels.

Product Development

Our long-term success will depend on our ability to enhance existing products and to introduce new products, such as our Phoenix FailSafe solution and our Phoenix HyperSpace product family, in a timely and cost-effective manner that meets the needs of customers in existing and emerging markets. There can be no assurance that we will

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be successful in developing new products or enhancing existing products, or that such products will be introduced before our competitors new releases. Delays in introducing products can adversely impact our ability to market and sell such products to potential customers, thereby adversely affecting the acceptance of and the revenue we may generate from such products. We have, from time to time, experienced such delays.

There can be no assurance that the new and/or enhanced products we have recently introduced will meet market requirements. Our software products and their enhancements contain complex code that may contain undetected errors and/or bugs when first introduced, which would adversely affect the commercial acceptance and success of such new products or enhancements.

Net Losses; Cash Flow

In the fiscal year 2007, we reported a net loss of $16.4 million and a negative net cash flow from operations of $2.4 million for the year, although we achieved positive net cash flow from operations in the third and fourth quarters. There can be no assurance that we will achieve profitability or be able to maintain positive cash flow in any future periods. If we do not become profitable within the timeframe expected by securities analysts or investors, the market price of our stock may decline.

We believe that we currently have sufficient liquidity to operate our business over the short term; however, our ability to meet our capital requirements over the long term depends upon the return of our operations to profitability and upon maintaining positive cash flow.

Attraction and Retention of Key Personnel

The success of our business will continue to depend upon certain key senior management and technical personnel. Competition for such personnel is intense, and there can be no assurance that we will be able to retain our existing key managerial, technical or sales and marketing personnel. The loss of key executives and employees in the future might adversely affect our business and impede the achievement of our business objectives.

In addition, our ability to achieve increased revenues and to develop successful new products and product enhancements will depend in part upon our ability to attract and retain highly skilled engineering, sales, marketing and administrative personnel. As we expand into new products and new markets, we increasingly need to hire people with backgrounds different from those required for our traditional CSS business. A failure to attract and retain employees with the necessary skill sets could adversely affect our business and operating results.

Competition

The markets for our products are intensely competitive and we expect both product and pricing competition to increase. Increased competition could result in pricing pressures, reduced margins, or the failure of one or more of our products to achieve or maintain market acceptance, any of which could adversely affect our business.

The Company competes for sales primarily with in-house R&D departments of PC and component manufacturers that may have significantly greater financial and technical resources, as well as closer engineering ties and experience with specific hardware platforms, than the Company. Major companies that use their own internal BIOS R&D personnel include Dell Inc., Hewlett-Packard Company, Toshiba Corporation, Apple Computer Inc. and Intel Corporation. In addition, some of these competitors are also our customers, suppliers and development partners. Any inability to effectively manage these complex relationships with customers, suppliers and development partners could have a material adverse effect on our business, operating results and financial condition and accordingly could affect our chances of success.

The Company also competes for business with other independent suppliers, including American Megatrends Inc., a privately held U.S. company, and Insyde Software Corp., a public company based and listed in Taiwan. Such privately held or foreign competitors may have significantly less onerous compliance obligations and therefore are likely to have lower cost structures than those of a US public company. Any resulting cost disadvantage to the Company could have an adverse impact of the Company s competitiveness, margins or profitability.

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The principal competitive factors in the markets in which we presently compete and may compete in the future include:

The ability to provide products and services that meet the needs of our target customers;

The functionality and performance of these products;

Price;

The ability to timely introduce new products; and

Overall company size and perceived stability.

There can be no assurance that we will be successful in our efforts to compete in any markets in which we operate.

Entrance into New or Developing Markets

As we continue to seek new market opportunities, we will likely increasingly encounter and compete with large, established suppliers as well as start-up companies. Some of our current and potential competitors may have greater resources, including technical and engineering resources, than we have. Additionally, as customers in these markets mature and expand, they may require greater levels of service and support than we have provided in the past. Our efforts to sell new firmware and CSS products for PCs as well as non-PC devices may require us to sell into markets, or to players in those markets, where we do not have significant prior experience and may require us to increase our spending levels for marketing and sales as well as research and development activities. Certain of our competitors may have an advantage over us because of their larger presence and deeper experience in these markets. There can be no assurance that we will be able to develop and market products, services, and support to effectively compete for these market opportunities. Further, provision of greater levels of services may result in a delay in the timing of revenue recognition.

End-User Demand for Device Security and Availability

Many of our products and product features, such as the security-related features in SecureCore and TrustedCore, and our new FailSafe solution are focused on helping to ensure that PCs and other digital devices are secure and available to the users, with a minimum of skill required for end-users to use these products. The success of our strategy depends on continued growth in end-user demand for these capabilities. Although factors such as global terrorism, the growing threat of identity theft, increased instances of malware and increased end-user reliance on their digital devices have all contributed to significant growth in demand for security-related products over the last several years, it is difficult to predict whether these trends will continue, accelerate or decelerate. Variations in demand for secure and available digital devices below our expectations could have a significant adverse impact on our operating results.

Dependence on New Product Releases by Our Customers

Successful introduction of new products is key to our success in both our CSS and new applications businesses. Frequently our new products are incorporated or used in our customers new products, making each party dependent on the other for product introduction schedules. In some instances, a customer may not be able to introduce one of its new products for reasons unrelated to our new product. In these cases, we would not be able to ship our new product until the customer had resolved its other difficulties. In addition, our customers may delay their product introductions due to market uncertainties in certain geographic regions. If our customers delay their product introductions, our ability to generate revenue from our own new products would be adversely affected.

Risks in Acquisitions

Our growth is dependent upon market growth and our ability to enhance our existing products and introduce new products on a timely basis. We have addressed and are likely to continue to address the need to introduce new

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products through both internal development and through acquisitions of other companies and technologies. Acquisitions involve numerous risks, including the following:

- Difficulties in integrating the operations, technologies, products and personnel of the acquired companies;
- Diversion of management s attention from normal daily operations of the business;
- Potential difficulties in completing projects associated with in-process research and development;
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
- Insufficient revenues to offset increased expenses associated with acquisitions; and
- Potential loss of key employees of the acquired companies.

Acquisitions may also cause us to:

- Issue common stock that would dilute our current stockholders percentage ownership;
- Assume liabilities, both known and unknown;
- Record goodwill and non-amortizable intangible assets that will be subject to impairment testing and potential periodic impairment charges;
- Incur amortization expenses related to certain intangible assets;
- Incur additional expense related to Sarbanes-Oxley compliance;
- Incur large and immediate write-offs of in-process research and development costs; and/or
- Become subject to litigation.

Mergers and acquisitions of high technology companies are inherently risky, and no assurance can be given that our previous or future acquisitions will be successful or will not adversely affect our business, operating results or financial condition, or result in significant or material control weaknesses with respect to Sarbanes-Oxley compliance. Failure to manage and successfully integrate acquisitions could harm our business and operating results in a material way. Even when an acquired company has already developed and marketed products, there can be no assurance that product enhancements will be made in a timely fashion or that pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products.

We have not recently made any acquisition that resulted in in-process research and development expenses being charged in an individual quarter. These charges may occur in future acquisitions in any particular quarter, resulting in variability in our quarterly earnings.

Litigation

From time to time, we become involved in litigation claims and disputes in the ordinary course of business. See Item 3 Legal Proceedings below. Litigation can be expensive, lengthy and disruptive to normal business operations.

Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit or proceeding could have a material adverse effect on our business, operating results or financial condition.

Protection of Intellectual Property

We rely on a combination of patent, trade secret, copyright, trademark and contractual provisions to protect our proprietary rights in our software products. There can be no assurance that these protections will be adequate or that competitors will not independently develop technologies that are substantially equivalent or superior to our technology. In addition, copyright and trade secret protection for our products may be unavailable or unreliable in certain foreign countries. As of September 30, 2007, we have been issued 79 patents in the U.S. and have 38 patent applications in process in the United States Patent and Trademark Office. On a worldwide basis, we have been issued 155 patents with respect to our product offerings and have 137 patent applications pending with respect to

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certain products we market. We also hold certain licenses and other rights granted to us by the owners of other patents. We maintain an active internal program designed to identify employee inventions we deem worthwhile to patent. There can be no assurance that any of the pending applications will be approved, and patents issued, or that our engineers will be able to develop technologies capable of being patented. Also, as the overall number of software patents increases, we believe that companies that develop software products may become increasingly subject to infringement claims.

There can be no assurance that a third party will not assert that their patents or other proprietary rights are violated by products offered by us. Any such claims, whether or not meritorious, may be time consuming and expensive to defend, may trigger indemnity obligations owed by us to third parties and may have an adverse effect on our business, results of operations and financial condition. Alleged infringement of valid patents or copyrights or misappropriation of valid trade secrets, whether alleged against us or our customers, and regardless of whether such claims have merit, could also have an adverse effect on our business, results of operations and financial condition.

Importance of Microsoft and Intel

For a number of years, we have worked closely with leading software and semiconductor companies, including Microsoft and Intel, in developing standards for the PC industry. Although we remain optimistic regarding relationships with these industry leaders, there can be no assurance that they or other software or semiconductor companies will not develop alternative product strategies that could conflict with our product plans and marketing strategies. Action by such companies may adversely impact our business and results of operations.

Intel is the leading semiconductor supplier to the customers of our CSS software products. Intel is developing and promoting software under the product name Tiano that competes with our CSS software products and offers this software at no charge through both custom and open source licenses. Some of our CSS competitors provide services and additional features for this Intel software, and we believe that in return Intel provides them with compensation and promotional benefits. We must continuously create new features and functions to sustain, as well as increase, our software s added value to our customers, particularly in light of Intel s initiative. There can be no assurances that we will be successful in these efforts.

Demand for Microsoft s Vista Operating System and for Newer Microprocessor Designs

The adoption of new primary PC technology related to operating systems and to microprocessor designs may have a significant impact on the relative demand for our different CSS products. In particular, Microsoft s new Vista operating system is designed to support security capabilities that will operate more effectively on PCs running SecureCore than on those running our older CSS versions. Similarly, some newer microprocessor designs offered by the silicon chip vendors may require the functionality provided by SecureCore to take full advantage of the new designs enhancements. For example, SecureCore is designed to be easily adaptable for the newer generation of multiple-core microprocessors offered by Intel and AMD while our older CSS versions will require more customization effort by our customers. As a result, the demand for SecureCore could vary in proportion to the rate at which Vista and these newer microprocessor designs are adopted. Such variations would not necessarily lead to changes in our market share for CSS; however, because we have entered into a significantly larger number of paid-up license agreements for our older CSS products than for SecureCore, our future reported revenues could be affected to the extent that revenues related to our older CSS products may already have been recognized.

Volatile Market for Phoenix Stock

The market for our stock is highly volatile. The trading price of our common stock has been, and will continue to be, subject to fluctuations in response to operating and financial results, changes in demand for our products and services,

announcements of technological innovations, the introduction and market acceptance of new technologies by us, our competitors, or other industry participants, changes in our product mix or product direction or the product mix or direction of our competitors, pricing pressure from our customers and competitors, changes in our revenue mix and revenue growth rates, changes in expectations of growth for the PC industry or the x86 based non-PC digital device industry, the overall trend toward industry consolidation both among our competitors and customers, the timing and size of orders from customers, our ability to maintain control over our costs, as well as other events or

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factors which we may not be able to influence or control. Statements or changes in opinions, ratings or earnings estimates made by brokerage firms and industry analysts relating to the markets in which we do business, companies with which we compete or relating to us specifically could have an immediate and adverse effect on the market price of our stock. In addition, the stock market has from time to time experienced extreme price and volume fluctuations that have particularly affected the market price for many small capitalization, high technology companies and have often been triggered by factors other than the operating performance of these companies. If the market value of our stock decreases below our net book value, we may have to record a charge for impairment of goodwill.

International Sales and Risks Associated with Operating Internationally

Revenues derived from international sales comprise a majority of total revenues. There can be no assurances that we will not experience significant fluctuations in international revenues. Our operations and financial results may be adversely affected by factors associated with international operations, such as changes in foreign currency exchange rates; restrictions on the transfer of funds; uncertainties related to regional economic circumstances; unexpected changes in local laws or regulations, or new or existing laws and regulations that we are not initially made aware of; political instability in emerging markets; terrorism and conflict; inflexible employee contracts in the event of business downturns; difficulties in attracting qualified employees; and language, cultural and other difficulties in managing foreign operations.

In addition, an increasing percentage of our labor force, particularly in engineering, is located in China, Taiwan and India. As of September 30, 2007, approximately 71%, or 237, of our employees are located outside of the U.S. Although one of our objectives in utilizing employees based in these markets is to ensure a supply of talented employees at lower expense than we incur in our other employee locations, there can be no assurances that a favorable market for employees will continue to exist in any of our foreign locations, or that changes in local conditions, such as labor laws and regulations, will not adversely affect our results of operations.