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PHOENIX TECHNOLOGIES LTD

Form 10-Q

May 07, 2010

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2010**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**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 Number)*

**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)*

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  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting  
company

(Do not check if smaller  
reporting company)

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

As of May 06, 2010, the number of outstanding shares of the registrant's common stock, \$0.001 par value, was 35,070,185.

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**FORWARD-LOOKING STATEMENTS**

This report on Form 10-Q 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: cash flow and future liquidity and financing requirements; research and development and other operating expenses; cost management and restructuring; expectations of sales volumes to customers and future revenue growth; new business and technology partnerships; exploration of strategic alternatives and options for certain of our products and services; plans to improve and enhance existing products; plans to continue to develop and market our new products; recruiting efforts; our relationships with key industry leaders; trends we anticipate in the industries and economies in which we operate; the outcome of pending disputes and litigation; our tax and other reserves; and other information that is not historical information. Words such as could, expects, may, anticipates, believes, projects, estimates, intends, plans and other similar expressions to indicate forward-looking 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 of this report. 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-Q include, but are not limited to: changes in demand for our products and services due to adverse economic conditions; our dependence on key customers; our ability to enhance existing products and develop and market new products and technologies successfully; the impact of any strategic alternatives we may pursue on our business and customer relationships; our ability to achieve and maintain profitability and positive cash flow from operations; our ability to generate additional capital in the future on terms acceptable to us; 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; our ability to maintain the average selling price of our core system software; end-user demand for products incorporating our products; the ability of our customers to introduce and market new products that incorporate our products; timing of payment by our customers; risks associated with any acquisition or disposition strategy that we might employ; costs and 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; fluctuations in our operating results and our ability to manage expenses consistent with our revenues; the effects of any software viruses or other breaches of our network security; failure to timely upgrade our information technology system; defects or errors in our products and services; consolidation in the industry in which we operate; risk associated with use of open source software; any material weakness in our internal controls over financial reporting; changes in financial accounting standards and our cost of compliance; business disruptions due to acts of war, power shortages and unexpected natural disasters; trends regarding the use of the x86 microprocessor architecture for personal computers and other digital devices; anti-takeover provisions in our charter documents; changes in our effective tax rates; and the validity of our tax positions. 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.

For a more detailed discussion of these and other risks associated with our business, see Item 1A Risk Factors in Part II of our Form 10-Q for the three-month period ended December 31, 2009 and Item 1A Risk Factors in our most recent annual report on Form 10-K for the fiscal year ended September 30, 2009.

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**PHOENIX TECHNOLOGIES LTD.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
*(in thousands)*  
*(unaudited)*

	March 31, 2010	September 30, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 25,324	\$ 35,062
Accounts receivable, net of allowances	4,381	6,505
Other assets current	1,247	2,196
Assets held for sale	6,456	
Total current assets	37,408	43,763
Property and equipment, net	3,046	4,881
Purchased technology and Intangible assets, net	2,615	7,608
Goodwill	17,414	22,205
Other assets noncurrent	882	3,082
Total assets	\$ 61,365	\$ 81,539
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 1,058	\$ 1,440
Accrued compensation and related liabilities	3,044	3,433
Deferred revenue current	14,504	20,770
Income taxes payable	1,047	4,136
Accrued restructuring charges current	349	146
Other liabilities current	2,813	2,989
Liabilities related to assets held for sale	2,479	
Total current liabilities	25,294	32,914
Accrued restructuring charges noncurrent	38	85
Deferred revenue noncurrent	1,090	898
Income taxes payable noncurrent	9,196	16,348
Other liabilities noncurrent	2,881	2,738
Total liabilities	38,499	52,983
Stockholders equity:		
Preferred stock		
Common stock	36	36

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Additional paid-in capital	258,487	257,975
Accumulated deficit	(142,868)	(137,058)
Accumulated other comprehensive loss	(663)	(344)
Less: Cost of treasury stock	(92,126)	(92,053)
Total stockholders equity	22,866	28,556
Total liabilities and stockholders equity	\$ 61,365	\$ 81,539

*See notes to unaudited condensed consolidated financial statements*

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**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
*(in thousands, except per share amounts)*  
*(unaudited)*

	Three months ended March 31, 2010	2009	Six months ended March 31, 2010	2009
<b>Revenues:</b>				
License fees	\$ 12,563	\$ 12,628	\$ 25,451	\$ 27,112
Subscription fees	7	67	8	129
Service fees	2,074	2,447	4,018	4,881
Total revenues	14,644	15,142	29,477	32,122
<b>Cost of revenues:</b>				
License fees	38	198	158	286
Subscription fees	11	101	20	160
Service fees	1,907	1,992	3,497	4,030
Amortization of purchased intangible assets	332	747	663	1,698
Impairment of purchased intangible assets		10,483		10,483
Total cost of revenues	2,288	13,521	4,338	16,657
Gross margin	12,356	1,621	25,139	15,465
<b>Operating expenses:</b>				
Research and development	7,697	10,313	16,121	20,781
Sales and marketing	3,268	5,218	7,973	10,141
General and administrative	2,533	4,987	7,222	10,607
Restructuring and asset impairment	755	957	1,236	1,050
Impairment of goodwill		23,872		23,872
Total operating expenses	14,253	45,347	32,552	66,451
Operating loss	(1,897)	(43,726)	(7,413)	(50,986)
Interest and other income (expenses), net	(41)	335	107	605
Loss from continuing operations before income taxes	(1,938)	(43,391)	(7,306)	(50,381)
Income tax (benefit) expense	490	221	(6,058)	1,620
Loss from continuing operations	(2,428)	(43,612)	(1,248)	(52,001)
Loss from discontinued operations, net of tax	(4,444)	(11,536)	(4,562)	(12,490)

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Net loss	\$ (6,872)	\$ (55,148)	\$ (5,810)	\$ (64,491)
Basic and diluted loss per share from:				
Continuing operations	\$ (0.07)	\$ (1.53)	\$ (0.04)	\$ (1.83)
Discontinued operations	\$ (0.13)	\$ (0.40)	\$ (0.13)	\$ (0.44)
Net loss	\$ (0.20)	\$ (1.93)	\$ (0.17)	\$ (2.27)

Shares used in loss per share calculation:

Basic and diluted 35,035 28,560 35,027 28,465

*See notes to unaudited condensed consolidated financial statements*

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**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(in thousands)*  
*(unaudited)*

	Six months ended March 31,	
	2010	2009
Cash flows from operating activities:		
Net loss	\$ (5,810)	\$ (64,491)
Reconciliation to net cash used in operating activities:		
Depreciation and amortization	2,013	3,035
Stock-based compensation	536	5,554
Loss from disposal/impairment of fixed assets	119	4
Impairment of purchased intangible assets	319	11,943
Impairment of goodwill	3,754	33,213
Change in operating assets and liabilities:		
Accounts receivable	1,927	(1,238)
Other assets	2,661	(146)
Accounts payable	(334)	(722)
Accrued compensation and related liabilities	1	(1,890)
Deferred revenue	(4,929)	1,306
Income taxes	(10,444)	447
Accrued restructuring charges	392	(161)
Other accrued liabilities	490	(888)
Net cash used in operating activities	(9,305)	(14,034)
Cash flows from investing activities:		
Purchases of property and equipment and other intangible assets	(258)	(1,467)
Acquisition of businesses, net of cash acquired	(204)	
Net cash used in investing activities	(258)	(1,671)
Cash flows from financing activities:		
Proceeds from stock issued under stock option and stock purchase plans	5	804
Repurchase of common stock	(102)	(87)
Principal payments under capital lease obligations	(281)	
Net cash provided by (used in) financing activities	(378)	717
Effect of changes in exchange rates	203	(114)
Net decrease in cash and cash equivalents	(9,738)	(15,102)
Cash and cash equivalents at beginning of period	35,062	37,721

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Cash and cash equivalents at end of period	\$ 25,324	\$ 22,619
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*See notes to unaudited condensed consolidated financial statements*

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**Note 1. Summary of Significant Accounting Policies**

*Basis of Presentation.* The Condensed Consolidated Financial Statements as of March 31, 2010 and for the three and six months ended March 31, 2010 and 2009 have been prepared by Phoenix Technologies Ltd. (the Company or Phoenix ), without an audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ) and in accordance with the Company s accounting policies as described in its latest Annual Report on Form 10-K filed with the SEC and in this Form 10-Q. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U. S. generally accepted accounting principles ( GAAP ) have been omitted pursuant to such rules and regulations. The Condensed Consolidated Balance Sheet as of September 30, 2009 was derived from the audited financial statements but does not include all disclosures required by GAAP. These Condensed Consolidated Financial Statements should be read in conjunction with the Company s audited financial statements and notes thereto included in the Company s Annual Report on Form 10-K for fiscal year ended September 30, 2009.

In the opinion of management, the unaudited Condensed Consolidated Financial Statements reflect all adjustments (which include normal recurring adjustments in each of the periods presented) necessary for a fair presentation of the Company s Results of Operations and Cash Flows for the interim periods presented and financial condition of the Company as of March 31, 2010. The results of operations for the interim periods are not necessarily indicative of results to be expected for the full fiscal year.

*Reclassifications.* The Company reclassified certain amounts previously reported in its financial statements to conform to the current presentation. These reclassifications had no impact on the Company s total assets, total liabilities or operating and net loss for any periods presented.

During the second quarter of fiscal year 2010, the Company classified revenues and expenses related to its eSupport disposal group as discontinued operations. Accordingly, the Condensed Consolidated Financial Statements have been reclassified for all periods presented to reflect current discontinued operations treatment. Unless noted otherwise, discussions in the Notes to Consolidated Financial Statements pertain to continuing operations.

*Use of Estimates.* The preparation of the Condensed Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances.

On an on-going basis, the Company evaluates its accounting estimates, including but not limited to: a) allowance for uncollectible accounts receivable; b) accruals for consumption-based license revenues; c) accruals for employee benefits; d) income taxes and realizability of deferred tax assets and the associated valuation allowances; and e) useful lives and/or realizability of carrying values for property and equipment, computer software costs, goodwill and intangibles, and prepaid royalties. Actual results could differ materially from those estimates.

*Revenue Recognition.* The Company licenses software under non-cancelable license agreements and provides services including non-recurring engineering, maintenance (consisting of product support services and rights to unspecified updates on a when-and-if available basis) and training.

Revenues from software license agreements are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. The Company uses the residual method to recognize revenues when an agreement includes one or more

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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elements to be delivered at a future date and vendor specific objective evidence ( VSOE ) of fair value exists for each undelivered element. VSOE of fair value is generally the price charged when that element is sold separately or, for items not yet being sold, it is the price established by management that will not change before the introduction of the item into the marketplace. Under the residual method, the VSOE of fair value of the undelivered element(s) is deferred and the remaining portion of the arrangement fee is recognized as revenue. If VSOE of fair value of one or more undelivered elements does not exist, revenue is deferred and recognized when delivery of those elements occurs or when fair value can be established.

The Company recognizes revenues related to the delivered products or services only if the above revenue recognition criteria are met, any undelivered products or services are not essential to the functionality of the delivered products and services, and payment for the delivered products or services is not contingent upon delivery of the remaining products or services.

**Volume Purchase Arrangements ( VPA )**

With respect to volume purchase agreements ( VPAs ) with original equipment manufacturers ( OEMs ) and original design manufacturers ( ODMs ), the Company recognizes license revenues for units consumed through the last day of the current accounting period, to the extent the customer has been invoiced for such consumption prior to the end of the current period and provided all other revenue recognition criteria have been met. If the customer agreement provides that the right to consume units lapses at the end of the term of the VPA, the Company recognizes revenues ratably over the term of the VPA if such ratable amount is higher than actual consumption as of the end of the current accounting period. Amounts that have been invoiced under VPAs and relate to consumption beyond the current accounting period are recorded as deferred revenues.

**Pay-As-You-Go Arrangements**

Under pay-as-you-go arrangements, license revenues from OEMs and ODMs are generally recognized in each period based on estimated consumption by the OEMs and ODMs of products containing the Company's software, provided that all other revenue recognition criteria have been met. The Company normally recognizes revenues for all consumption prior to the end of the accounting period. Since the Company generally receives quarterly reports from OEMs and ODMs approximately 30 to 60 days following the end of a quarter, it has put processes in place to reasonably estimate revenues, by obtaining estimates of production from OEM and ODM customers and by utilizing historical experience and other relevant current information. To date the variances between estimated and actual revenues have been immaterial.

**Services Arrangements**

Revenues for non-recurring engineering services are generally on a time and materials basis and are recognized as the services are performed. Software maintenance revenues are recognized ratably over the maintenance period, which is typically one year. Training and other service fees are recognized as services are performed. Amounts billed in advance for services that are in excess of revenues recognized are recorded as deferred revenues.

*Amortization of Acquired Intangible Assets.* Purchased intangible assets consist primarily of purchased technology, customer relationships, non-compete agreements and trade names and others. These acquired intangible assets were accounted for in accordance with the authoritative accounting pronouncements at the time of respective acquisitions dates. The Company amortizes intangible assets other than goodwill over their useful lives unless their lives are determined to be indefinite. The annual amortization is the greater of the amount computed using (a) the ratio that current gross revenues for a

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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product bear to the total of current and anticipated future gross revenues for that product or (b) the straight-line method over the remaining estimated economic life of the product including the period being reported on.

The Company assesses the carrying value of long-lived assets at each balance sheet date or whenever events or changes in circumstances indicate that the carrying value of these long-lived assets may not be recoverable. Factors the Company considers important which could result in an impairment review include (1) significant under-performance relative to the expected historical or projected future operating results, (2) significant changes in the manner of use of assets, (3) significant negative industry or economic trends, and (4) significant changes in the Company's market capitalization relative to net book value. Any changes in key assumptions about the business or prospects, or changes in market conditions, could result in an impairment charge and such a charge could have a material adverse effect on the Company's results of operations.

Determination of recoverability of long-lived assets is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets that management expects to hold and use is based on the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell. If quoted market prices for the assets are not available, the fair value is calculated using the present value of estimated expected future cash flows. The cash flow calculations are based on management's best estimates at the time the tests are performed, using appropriate assumptions and projections. Management relies on a number of factors including operating results, business plans, budgets, and economic projections. In addition, management's evaluation considers non-financial data such as market trends, customer relationships, buying patterns, and product development cycles. When impairments are assessed, the Company records charges to reduce long-lived assets based on the amount by which the carrying amounts of these assets exceed their fair values.

During the quarter ended March 31, 2010, due to the Company's decision to sell the assets associated with its eSupport disposal group, as well as its FailSafe and HyperSpace product lines, management performed an interim impairment analysis with respect to goodwill and other long-lived assets as of March 31, 2010. For the purposes of this impairment analysis, the Company determined its estimate of fair value using the income approach, which estimates the fair value of the Company's reporting units, or part thereof, based on future discounted cash flows. As a result of this analysis, during the second quarter of fiscal 2010, the Company recorded an aggregate impairment charge of \$0.3 million with respect to its purchased intangible assets associated with eSupport disposal group, which is reported as discontinued operations. During the quarter ended March 31, 2009, the Company had recorded an aggregate impairment charge of \$11.9 million with respect to purchased intangible assets. Out of this total impairment charge, \$1.5 million related to eSupport and is reclassified to discontinued operations. The Company did not record any impairment charges on the purchased intangible assets during the three months ended December 31, 2009 or December 31, 2008.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

The following tables summarize the carrying value, amortization and impairment/write off of purchased technology and other intangibles assets as of March 31, 2010 and September 30, 2009 (*in thousands*):

	As of March 31, 2010				
	Gross	Accumulated	Impairment/ Write-off	for Sale	Net Carrying Amount
	Carrying Amount	Accumulated Amortization		Assets Held for Sale	
Purchased technologies	\$ 16,484	\$ (3,753)	\$ (6,611)	\$ (3,719)	\$ 2,401
Customer relationships	6,349	(1,003)	(5,235)	(11)	100
Non compete agreements	279	(90)	(145)		44
Trade names and others	512	(143)	(222)	(77)	70
	<b>\$ 23,624</b>	<b>\$ (4,989)</b>	<b>\$ (12,213)</b>	<b>\$ (3,807)</b>	<b>\$ 2,615</b>

  

	As of September 30, 2009				
	Gross	Accumulated	Impairment/ Write-off	Classified as Assets held for Sale	Net Carrying Amount
	Carrying Amount	Accumulated Amortization			
Purchased technologies	\$ 16,555	\$ (3,026)	\$ (6,302)	\$	\$ 7,227
Customer relationships	6,349	(985)	(5,231)		133
Non compete agreements	279	(74)	(145)		60
Trade names and others	512	(108)	(216)		188
	<b>\$ 23,695</b>	<b>\$ (4,193)</b>	<b>\$ (11,894)</b>	<b>\$ </b>	<b>\$ 7,608</b>

The remaining intangible assets as of March 31, 2010 have weighted-average useful lives of 3.4 years each for purchased technologies and customer relationships, 1.4 years for non-compete agreements and 2.4 years for trade names and others. Amortization of purchased intangible assets were \$0.3 million and \$0.7 million for the three and six months period ended March 31, 2010, respectively, and was \$0.7 million and \$1.7 million for the three and six months period ended March 31, 2009, respectively.

The following table summarizes the expected annual amortization expense of the remaining intangibles assets at March 31, 2010 (*in thousands*):

	Expected Amortization Expense
Fiscal year ending September 30,	
2010	\$ 396
2011	790
2012	758
2013	671
Total	\$ 2,615

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*Goodwill.* Goodwill represents the excess purchase price of net tangible and intangible assets acquired in business combinations over their estimated fair value. The Company tests goodwill for impairment on an annual basis or more frequently, if impairment indicators arise, and writes down the value when considered impaired.

The goodwill impairment analysis is performed at the reporting unit level at least annually and more frequently upon the occurrence of certain events. The annual test of goodwill impairment is

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

performed as of September 30 using a two-step process. First, the Company determines if the carrying amount of its reporting unit exceeds the fair value of the reporting unit, which would indicate that goodwill may be impaired. Then, if the Company determines that goodwill may be impaired, the Company compares the implied fair value of the goodwill to its carrying amount to determine if there is an impairment loss. Due to similar reasons that led the Company to test its intangible assets for impairment on an interim basis as described above, the Company performed an interim impairment test for goodwill as of March 31, 2010. Similar to the process followed for the impairment analysis of the intangible assets, the Company based estimates of fair value using the income approach. The significant estimates used included the Company's weighted average cost of capital, long-term rate of growth, profitability of operations and working capital effects. The assumptions are based on the actual historical performance of the Company's reporting units and take into account management expectations of the future operations. Based on its interim analysis, the Company recorded an aggregate impairment charge of \$3.8 million for goodwill associated with its eSupport disposal group, which is reported as discontinued operations. During the quarter ended March 31, 2009, the Company had recorded an aggregate goodwill impairment charge of \$33.2 million. Of this total impairment charge, \$9.3 million related to eSupport and is reclassified to discontinued operations. The Company did not record any goodwill impairment charges during the three months ended December 31, 2009 or December 31, 2008.

*Income Taxes.* The Company uses the asset and liability method to account for income taxes. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period of enactment. The Company records a valuation allowance to reduce deferred tax assets to an amount whose realization is more likely than not.

The Company applies the provisions of Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) 740, *Income Taxes*, to its uncertain income tax positions. ASC 740 provides recognition criteria and a related measurement model for tax positions taken by companies and prescribes a threshold for the financial statement recognition and measurement of a tax position taken or expected to be taken in a future tax filing that is reflected in measuring current or deferred income tax assets and liabilities. In accordance with ASC 740, the Company determines whether the benefits of tax positions are more likely than not (likelihood of greater than 50%) of being sustained upon audit based on the technical merits of the tax position. For tax positions that are more likely than not of being sustained upon audit, the Company uses a probability weighted approach and recognize the largest amount of the benefit that is more than 50% likely of being sustained in the financial statements. For tax positions that are not more likely than not of being sustained upon audit, the Company does not recognize any portion of the benefit in the financial statements.

*Stock-Based Compensation.* The Company currently uses the Black-Scholes option pricing model to determine the fair value of stock options and employee stock purchase plan shares which contain a service condition. In addition, the Company uses the Monte-Carlo simulation option-pricing model to determine the fair value of stock option grants that contain a market condition. The Monte-Carlo simulation option-pricing model takes into account the same input assumptions as the Black-Scholes model; however, it also further incorporates into the fair-value determination, the possibility that the market condition may not be satisfied. The determination of the fair value of stock-based payment awards using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of complex and subjective variables. The models require inputs such as expected term, expected volatility, expected dividend yield and the risk-free interest rate. Further, the forfeiture rate of options also affects the amount of aggregate compensation. These inputs are subjective and

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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generally require significant analysis and judgment to develop. While estimates of expected term, volatility and forfeiture rate are derived primarily from the Company's historical data, the risk-free interest rate is based on the yield available on U.S. Treasury zero-coupon issues. The Company has divided option recipients into three groups (outside directors, officers and non-officer employees) and determined the expected term and anticipated forfeiture rate for each group based on the historical activity of that group. The expected term is then used in determining the applicable volatility and risk-free interest rate.

The compensation costs related to awards with a market-based condition are recognized regardless of whether the market condition is satisfied, provided that the requisite service has been provided. The compensation costs recognized for awards, other than those attached with the market-based conditions, includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of, October 1, 2005, based on the grant date fair value and amortized on a graded vesting basis over the options' vesting period, and (b) compensation cost for all share-based payments granted subsequent to October 1, 2005, based on estimated fair value on the grant-date and amortized on a straight-line basis over the options' vesting period. There was no capitalized stock-based employee compensation cost as of March 31, 2010.

The Company has elected to use the alternative transition provisions as described in the original accounting standard for the calculation of its pool of excess tax benefits available to absorb tax deficiencies recognized. There has been no recognized tax benefit relating to stock-based employee compensation as of March 31, 2010.

The following table shows total stock-based compensation expense included in the Condensed Consolidated Statement of Operations for the three and six months ended March 31, 2010 and 2009 (*in thousands*):

	Three months ended March 31,		Six months ended March 31,	
	2010	2009	2010	2009
Cost of revenues	68	\$ 90	\$ 141	\$ 275
Research and development	464	719	904	1,572
Sales and marketing	248	293	429	722
General and administrative	(2,022)	1,268	(1,002)	2,859
Stock-based compensation expense (benefit) for continuing operations	(1,242)	2,370	472	5,428
Stock-based compensation expense for discontinued operations	31	53	64	126
Total stock-based compensation (benefit) expense	\$ (1,211)	\$ 2,423	\$ 536	\$ 5,554

During the current quarter ended March 31, 2010, the Company terminated the employment of two of its most senior executive officers and accordingly reversed previously recognized stock-based compensation cost of \$2.6 million for certain awards with market conditions, as the requisite service period was not rendered for certain tranches of these awards. Since the reversal of expense exceeded the compensation expense of \$1.4 million recorded on all other stock awards, this resulted in a net stock-based compensation benefit of \$1.2 million for the current quarter as compared to \$2.4 million of expense recorded for the comparable quarter of fiscal year 2009. Due in part to the reason mentioned above, the expense of \$0.5 million for the six months ended March 31, 2010 is also significantly lower than the expense of \$5.6 million recorded during the corresponding six months period of fiscal year 2009.

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The fair value of the options granted in the three and six month periods ended March 31, 2010 and 2009 reported above has been estimated as of the date of the grant using either a Monte Carlo option pricing model or a Black-Scholes single option pricing model with the following assumptions:

	Employee Stock Options			
	Three months ended		Six months ended March	
	March 31,	March 31,	2010	2009
Expected life from grant date (in years)	5.0 - 6.0	4.0 - 10.0	5.0 - 6.0	4.0 - 10.0
Risk-free interest rate	2.4 - 2.8%	1.4 - 2.6%	0.3 - 5.0%	1.4 - 3.4%
Volatility	0.8	0.7 - 0.8	0.8	0.6 - 0.8
Dividend yield	None	None	None	None

  

	Employee Stock Purchase Plan			
	Three months ended		Six months ended March 31,	
	March 31,	March 31,	2010	2009
Expected life from grant date (in years)		0.5	0.5 - 1.0	
Risk-free interest rate		0.7%	0.7 - 0.9%	
Volatility		0.9	0.9 - 1.3	
Dividend yield		None	None	

The aforementioned inputs entered into the option valuation models the Company uses to fair value the stock option grants are subjective estimates and changes to these estimates will cause the fair value of the stock options and related stock-based compensation expense to vary. To the extent the Company changes the terms of its employee stock-based compensation programs or refines different assumptions in future periods such as the expected term or forfeiture rate, the stock-based compensation expense in future periods may differ significantly from the expense recorded in previous reporting periods.

*Computation of Earnings (Loss) per Share.* Basic net earnings (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net earnings per share is computed using the weighted-average number of common and dilutive potential common shares outstanding during the period. Dilutive common-equivalent shares primarily consist of employee stock options computed using the treasury stock method. The treasury stock method assumes that proceeds from exercise are used to purchase common stock at the average market price during the period, which has the impact of reducing the dilution from options. Stock options will have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options. Also, for periods in which the Company reports a net loss, diluted net loss per share is computed using the same number of shares as is used in the calculation of basic net loss per share because adding potential common shares outstanding would have an anti-dilutive effect. See Note 9 Loss per Share for more information.

*New Accounting Pronouncements.* In the first quarter of fiscal year 2010, the Company adopted new standards that specified the way in which fair value measurements should be made for non-financial assets and non-financial liabilities that are not measured and recorded at fair value on a recurring basis, and specified additional disclosures related to these fair value measurements. The adoption of these new standards did not have a significant impact on the Company's Condensed Consolidated Financial Statements.

In the first quarter of fiscal year 2010, the Company adopted revised standards for business combinations. The new guidance retains the fundamental requirements of the original pronouncement requiring that the acquisition method of accounting, or purchase method, be used for all business



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combinations. The new guidance defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquirer achieves control and requires the acquirer to recognize the assets acquired, liabilities assumed and any noncontrolling interest at their fair values as of the acquisition date. In addition it requires, among other things, expensing of acquisition-related and restructuring-related costs, measurement of pre-acquisition contingencies at fair value, measurement of equity securities issued for purchase at the date of close of the transaction and capitalization of in-process research and development, all of which represent modifications to current accounting for business combinations. In addition, under the new guidance, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact the income tax provision. These new standards are applicable to business combinations on a prospective basis beginning in the first quarter of fiscal year 2010. The adoption of this new guidance had no impact on the Company's Condensed Consolidated Financial Statements since the Company did not enter into any such business combinations transactions during the current reporting period.

In the first quarter of fiscal year 2010, the Company adopted the new standard to assist in the assessment of the useful life of intangible assets subject to renewal or extension provisions. This standard requires an entity to consider its own assumptions about renewal or extension of the term of the arrangement, consistent with its expected use of the asset. This standard is required to be applied prospectively to all intangible assets acquired. The adoption of the new standard had no impact on the Company's Condensed Consolidated Financial Statements for the current reporting period since the Company did not acquire any new intangible assets during the current reporting period.

In the first quarter of fiscal year 2010, the Company adopted the new standard that clarified how to measure the fair value of liabilities in circumstances when a quoted price in an active market for the identical liability is not available. Application of this new authoritative guidance had no impact on the Company's Condensed Consolidated Financial Statements for the current reporting period.

**Note 2. Assets Held for Sale and Discontinued Operations**

During the first fiscal quarter of 2010, the Company announced a change to its business strategy to enable management to focus its attention on the Company's core competencies. The strategy called for exploring strategic alternatives for the Company's FailSafe, Freeze, HyperSpace and eSupport products and services, including the possible divestiture or winding-down of these product lines. As part of this strategy, the Company decided to sell these assets during the current quarter and accordingly classified the assets and liabilities associated with these products and services as disposal groups "Held-for-Sale" as of March 31, 2010. In addition, the results of operations associated with eSupport products and services have been classified as discontinued operations for all periods presented. For a period of time up to the actual disposal, which is currently not expected to be greater than 12 months, the Company will continue to record cash inflows and outflows associated with eSupport products and services in its income statement as part of the discontinued operations. The Company currently does not expect continuation of cash flows after the consummation of any disposal transaction for the eSupport disposal group. FailSafe, Freeze and HyperSpace products do not qualify as separate business operations, and related revenues and expenses therefore continue to be reflected in continuing operations.

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The following table presents the carrying amounts of major classes of assets and liabilities related to assets held for sale as of March 31, 2010 (*in thousands*):

	As of March 31, 2010
<b>Assets</b>	
Purchased technology and Intangible assets, net	\$ 3,807
Goodwill	1,037
Property and equipment, net	1,043
Other current assets	343
Other assets noncurrent	226
 Total assets held for sale	 \$ 6,456
 <b>Liabilities</b>	
Deferred revenues	\$ 1,264
Accrued compensation and related liabilities	390
Other current liabilities	775
Other liabilities noncurrent	50
 	 \$ 2,479

The following table presents the revenues and other components of discontinued operations (*in thousands*):

	Three months ended March 31,		Six months ended March 31,	
	2010	2009	2010	2009
Revenues	\$ 655	\$ 675	\$ 1,412	\$ 1,062
 Expenses:				
Impairment of goodwill, tangible and intangible assets, and costs to sell	\$ 4,289	\$ 10,801	\$ 4,289	\$ 10,801
Other costs	810	1,410	1,685	2,751
 Total expenses	 \$ 5,099	 \$ 12,211	 \$ 5,974	 \$ 13,552
 Loss from discontinued operations, net of tax \$0	 (\$4,444)	 (\$11,536)	 (\$4,562)	 (\$12,490)

**Note 3. Fair Values**

The Company performs fair value measurements in accordance with the guidance provided by fair value standards. The fair value standards define fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of

nonperformance.

The guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors market participants would use in valuing the asset or liability. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The guidance requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three levels:

Level 1: the use of quoted prices for identical instruments in active markets;

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Level 2: the use of quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active or are directly or indirectly observable or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3: the use of one or more significant inputs that was unobservable and supported by little or no market activity and that reflect the use of significant management judgment. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, and significant management judgment or estimation.

All of the Company's financial instruments, which represent investments in money market funds and classified as cash equivalents in the Condensed Consolidated Balance Sheet, are carried at fair value.

The following table summarized the carrying amounts and fair values of financial assets subject to fair value measurements at March 31, 2010 (*in thousands*):

	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs
Balance at March 31, 2010	(Level 1)	(Level 2)	(Level 3)
<b>Assets:</b>			
<b>Cash equivalents:</b>			
Money market funds	\$ 11,353	\$ 11,353	
Total	\$ 11,353	\$ 11,353	

As of March 31, 2010, the Company did not have any Level 2 or Level 3 financial assets or liabilities nor were there any transfers of financial assets and liabilities between any of the categories during the quarter ended March 31, 2010.

**Assets and Liabilities Measured at Fair Value on a Non-recurring Basis**

The Company measures its disposal groups held for sale at the lower of their carrying amount or fair value less cost to sell. The following table summarizes the Company's net assets of the disposal group held for sale which is measured at fair value as of March 31, 2010:

	Balance at March 31, 2010	Unobservable Inputs (Level 3)	Loss for the three and six months ended March 31, 2010
Net assets of disposal group held for sale measured at fair value	\$ 1,000	\$ 1,000	\$ 4,289
Total	\$ 1,000	\$ 1,000	\$ 4,289

The Company has classified the net assets of its disposal group held for sale and measured at fair value as Level 3 due to the lack of observable inputs to determine the fair values of such net assets. The fair value of net assets of the disposal group held for sale is determined considering active bids from potential buyers and also using the income valuation approach. Significant unobservable inputs used in the income approach primarily include internal cash flow projections and discount rates. Discount rates are calculated using mathematical models that utilize observable inputs such as risk-free interest rates and beta, adjusted for company specific characteristics.

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During the three months ended March 31, 2010, net assets of eSupport disposal group held for sale which are measured at fair value, with a carrying amount of \$5.3 million, were written down to their fair value of \$1.2 million less costs to sell of \$0.2 million (or \$1.0 million), resulting in a loss of \$4.3 million which is included in Loss from discontinued operations, net of tax.

**Note 4. Comprehensive Loss**

The following are the components of comprehensive loss (*in thousands*):

	Three months ended March 31,		Six months ended March 31,	
	2010	2009	2010	2009
Net loss	\$ (6,872)	\$ (55,148)	\$ (5,810)	\$ (64,491)
Other comprehensive income (loss)				
Net change in defined benefit obligation	(3)	(3)	(6)	(6)
Net change in cumulative translation adjustment	(39)	225	(313)	647
Comprehensive loss	\$ (6,914)	\$ (54,926)	\$ (6,129)	\$ (63,850)

**Note 5. Restructuring and Asset Impairment Charges**

Restructuring and related asset impairment charges are presented as a separate line item in the Condensed Consolidated Statement of Operations. The following table summarizes the activity related to the asset/liability for restructuring and related asset impairment charges through March 31, 2010 (*in thousands*):

	Facilities and Other Exit Costs Fiscal Year 2007 Plans	Severance and Benefits Fiscal Year 2009 Plans	Facilities and Other Exit Costs Fiscal Year 2009 Plans	Severance and Benefits Fiscal Year 2009 Plans	Facilities and Other Exit Costs Fiscal Year 2010 Plan
<b>Balance of accrual/(other assets) at September 30, 2008</b>	\$ 50				
Cash payments		(93)			
True up adjustments		49			
<b>Balance of accrual/(other assets) at December 31, 2008</b>		6			
Provision in fiscal year 2009 plans continuing operations			\$ 944		
Provision in fiscal year 2009 plans discontinued operations			92		
Cash payments	(12)		(718)		
Non-cash settlements					
True up adjustments	13				
<b>Balance of accrual/(other assets) at March 31, 2009</b>	7		318		

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Provision in fiscal year 2009		\$	157
plans	(11)	(461)	(81)
Cash payments			(76)
Non-cash settlements			
True up adjustments	4	199	
<b>Balance of accrual/(other assets) at June 30, 2009</b>		56	
Provision in fiscal year 2009			
plans continuing operations		159	101
Provision in fiscal year 2009			
plans discontinued			
operations		1	
Cash payments	(35)	(138)	
Non-cash settlements			(101)
True up adjustments	213	(78)	6
<b>Balance of accrual/(other assets) at September 30, 2009</b>		6	
Provision in fiscal year 2010			
plan		\$	383
Cash payments	(14)		(326)
Non-cash settlements			(44)
True up adjustments	33		
<b>Balance of accrual/(other assets) at December 31, 2009</b>		6	57
Provision in fiscal year 2010			
plan continuing operations			755
Provision in fiscal year 2010			
plan discontinued			
operations		22	
Cash payments	(34)		(409)
Non-cash settlements			(2)
Liabilities related to assets for sale			(246)
True up adjustments	(2)		
<b>Balance of accrual/(other assets) at March 31, 2010</b>	\$ 161	\$ 6	\$ 179

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**Fiscal Year 2010 Restructuring Plan**

In October 2009, a restructuring plan was approved to close the Company's facility in Nanjing, China in order to consolidate development activities in the Company's other locations. The actions under this restructuring activity involved terminating or relocating approximately 34 employees to the Company's other locations and vacating the Nanjing facility. The Company recorded a restructuring charge of approximately \$0.4 million for this plan in the quarter ended December 31, 2009, which is comprised of employee relocation and severance costs, asset impairments and certain other exit costs. These restructuring costs, which represent the total amount of expenses incurred in connection with the closure of the Nanjing facility, are included in the Company's results of operations. The payments related to this restructuring program were substantially completed as of March 31, 2010.

In January 2010, a restructuring plan was approved for the purpose of reducing future operating expenses by eliminating 37 employee positions. During the three months ended March 31, 2010, the Company recorded a restructuring charge of approximately \$0.8 million for this plan all of which related to severance and other employee costs. These restructuring costs, which represent the total amount of expenses expected to be incurred in connection with this restructuring plan, are included in the Company's results of operations for the quarter ended March 31, 2010 and the total estimated unpaid portion of the cost of this restructuring plan was \$0.2 million as of such date.

**Fiscal Year 2009 Restructuring Plans**

In July 2009, a restructuring plan was approved to close the Company's facility in Shanghai, China in order to consolidate development activities in the Company's other locations. The actions under this restructuring activity involved terminating or relocating approximately 34 employees to the Company's other locations and vacating the Shanghai facility.

In April 2009, a restructuring plan was approved for the purpose of consolidating development activities carried out in the Company's two locations in India at Bangalore and Hyderabad. In order to consolidate development activities solely at the Company's Bangalore, India location, management approved the closure of the Company's facility in Hyderabad, India. The actions under this restructuring plan involved relocating approximately 33 employees at the Hyderabad location to the Bangalore site, terminating employees that did not relocate, and vacating the Hyderabad facility.

In the second quarter of fiscal year 2009, management approved two restructuring plans. In February 2009, a restructuring plan was approved to reduce future operating expenses, eliminate overlapping functions and eliminate employees not meeting Company performance expectations. In March 2009, another restructuring plan was approved for the purpose of reducing future operating expenses by eliminating employee positions and closing the Company's facility in Tel Aviv, Israel. As a result of these restructuring activities, the Company reduced its global workforce by 96 employees, although these reductions were partially offset by other workforce additions during the year.

During the year ended September 30, 2009, the Company recorded an aggregate charge of approximately \$1.5 million with respect to fiscal year 2009 restructuring plans, related to employee relocation and severance costs, asset impairments and certain other exit costs. These restructuring costs, which represent the total amount of expenses incurred in connection with fiscal year 2009 restructuring plan, are included in the Company's results of operations. The payments related to these restructuring programs were substantially completed prior to the end of fiscal year 2009.

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**Fiscal Year 2007 Restructuring Plans**

In the fourth quarter of fiscal year 2007, a restructuring plan was approved for the purpose of reducing future operating expenses by eliminating 12 employee positions and closing the Company's office in Norwood, Massachusetts. The Company recorded a restructuring charge of approximately \$0.6 million in fiscal year 2007, which consisted of the following: (i) \$0.4 million related to severance costs and (ii) \$0.2 million related to on-going lease obligations for the Norwood facility, net of estimated sublease income. These restructuring costs are included in the Company's results of operations. In addition, restructuring charges aggregating to \$0.2 million were recorded in the second and fourth quarters of fiscal year 2009 due to changes in operating expenses and estimates of sublease income associated with this restructuring program. In the quarter ended December 31, 2009, restructuring charges of approximately \$34,000 were recorded due to changes in operating expenses and estimates of sublease income associated with this restructuring program. The total estimated unpaid portion of the cost of this restructuring is \$0.2 million as of March 31, 2010.

In the first quarter of fiscal year 2007, a restructuring plan was approved that was designed to reduce operating expenses by eliminating 58 employee positions and closing or consolidating offices in Beijing, China; Taipei, Taiwan; Tokyo, Japan; and Milpitas, California. The Company recorded a restructuring charge of approximately \$1.9 million in the first quarter of fiscal year 2007 related to the reduction in staff. In addition, restructuring charges of \$0.9 million and \$0.3 million were recorded in the second and fourth quarter, respectively, of fiscal year 2007 in connection with office consolidations. In fiscal year 2009, the Company recorded approximately \$40,000 related to a true-up adjustment due to changes in operating expenses and estimates of sublease income associated with this restructure program. These restructuring costs are included in the Company's results of operations.

As of March 31, 2010, the first quarter 2007 restructuring plan has an asset balance of approximately \$40,000 which is classified under the captions Other assets current and Other assets noncurrent in the Condensed Consolidated Balance Sheets. This balance relate solely to the restructuring activity which was recorded in the fourth quarter of fiscal year 2007 as noted above. All other restructuring liabilities associated with the first quarter 2007 plan have been fully paid. When the reserve was first established in the fourth quarter of fiscal 2007, it had a liability balance of \$0.3 million which was comprised of a projected cash outflow of approximately \$3.0 million less a projected cash inflow of approximately \$2.7 million, though the reserve was later increased by \$0.1 million as the result of a change in estimated expenses. The source of the cash inflow is a sublease of the facility that the Company had vacated, and the sublease was executed as anticipated. Since the projected cash inflows exceed the projected cash outflows for the remaining period of the lease, the net balance is classified as an asset rather than a liability.

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**Note 6. Property and Equipment, Net**

Property and equipment consisted of the following (*in thousands, except estimated useful life*):

	Estimated useful life (years)	March 31, 2010	September 30, 2009
Computer hardware and software	3	\$ 6,691	\$ 8,131
Telephone system	5	321	389
Furniture and fixtures	5	1,466	1,933
Leasehold improvements		1,716	2,299
 Subtotal		10,194	12,752
Less: accumulated depreciation		(7,148)	(7,871)
 Property and equipment, net		\$ 3,046	\$ 4,881

The Company has entered into equipment financing lease arrangements, which allows the Company to acquire up to a total of \$1.4 million in equipment. As of March 31, 2010, the Company has fully utilized these equipment financing lease arrangements.

As of March 31, 2010, the current portion of the present value of the net minimum lease payments is \$0.6 million.

The following is a schedule by years of future minimum lease payments for assets acquired under capital leases together with the present value of the net minimum lease payments as of March 31, 2010 (*in thousands*):

Fiscal years ending September 30,		
2010		\$ 331
2011		506
2012		106
 Total minimum lease payments		943
Less: amount representing interest		(56)
 Sub-total of present value of net minimum lease payments		887
Classified as liabilities related to assets held for sale		(65)
 Present value of net minimum lease payments		\$ 821

Depreciation expense related to property and equipment, including equipment under capital lease and amortization of leasehold improvements, totaled \$0.5 million and \$1.1 million for the three and six months ended March 31, 2010, respectively. For the three and six months ended March 31, 2009, the depreciation expense was \$0.5 million and \$1.0 million, respectively.

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**Note 7. Other Assets Current and Noncurrent; Other Liabilities Current and Noncurrent**

The following table provides details of other assets current (*in thousands*):

	March 31, 2010	September 30, 2009
Other assets current:		
Prepaid taxes	\$ 25	\$ 67
Prepaid other	912	1,630
Other assets	310	499
Total other assets current	\$ 1,247	\$ 2,196

The following table provides details of other assets noncurrent (*in thousands*):

	March 31, 2010	September 30, 2009
Other assets noncurrent:		
Deposits and other prepaid expenses	\$ 642	\$ 991
Long-term prepaid taxes		1,879
Deferred tax	240	212
Total other assets noncurrent	\$ 882	\$ 3,082

Long-term prepaid taxes as of September 30, 2009 represented amounts paid as an advance to the Taiwan National Tax Authority (the TNTA) pending final tax assessments under Taiwanese transfer pricing guidelines for the periods beginning from fiscal year 2000. During the quarter ended December 31, 2009, the Company received final tax assessments from the TNTA for fiscal years 2000 through 2006, which called for total tax and interest payments of approximately \$4.0 million. During the quarter ended December 31, 2009, the Company made cash payments to the TNTA totaling \$2.1 million and adjusted the aforementioned prepaid taxes by decreasing the remaining amount due to be paid under the final tax assessments. See Note 12 Income Taxes for more information.

The following table provides details of other liabilities current (*in thousands*):

	March 31, 2010	September 30, 2009
Other liabilities current:		
Accounting and legal fees	\$ 682	\$ 519
Obligations under capital lease	576	501
Other accrued expenses	1,555	1,969
Total other liabilities current	\$ 2,813	\$ 2,989

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The following table provides details of other liabilities noncurrent (*in thousands*):

			September 30, 2009
		March 31, 2010	
Other liabilities noncurrent:			
Deferred rent	\$ 619	\$ 702	
Retirement reserve	1,974		1,527
Obligations under capital lease	245		452
Other liabilities	43		57
Total other liabilities noncurrent	\$ 2,881	\$ 2,738	

**Note 8. Segment Reporting and Significant Customers**

The Company has defined one reportable segment, described below, based on factors such as how the Company's operations are managed and how the chief operating decision maker views results. The reportable segment is established based on various factors including evaluating the Company's internal reporting structure by the chief operating decision maker and disclosure of revenues and operating expenses. The chief operating decision maker reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by geographic region and by licenses, service and subscription revenues, for purposes of making operating decisions and assessing financial performance. The chief operating decision maker does not assess the performance of the Company's products, services and geographic regions on other measures of income or expense, such as depreciation and amortization or net income. Financial information required to be disclosed in accordance with the applicable authoritative guidance on Segment Reporting is included on the Condensed Consolidated Statements of Operations. In addition, as the Company's assets are primarily located in its corporate office in the United States and not allocated to any specific region, it does not produce reports for, or measure the performance of its geographic regions based on any asset-based metrics. Therefore, geographic information is presented only for revenues from external customers.

Revenues from external customers by geographic area, which is determined based on the location of the customers, is categorized into five major countries/regions: North America, Japan, Taiwan, Other Asian countries and Europe as follows (*in thousands*):

	Three months ended March 31,		Six months ended March 31,	
	2010	2009	2010	2009
Revenues:				
North America	\$ 3,633	\$ 3,283	\$ 6,017	\$ 6,603
Japan	2,649	3,126	5,127	6,973
Taiwan	6,151	6,859	13,924	15,034
Other Asian countries	1,780	1,019	3,456	2,123
Europe	431	855	953	1,389
Total revenues from continuing operations	14,644	15,142	29,477	32,122
Total revenues from discontinued operations	655	675	1,412	1,062
Total revenues	\$ 15,299	\$ 15,817	\$ 30,889	\$ 33,184

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Substantially all of North America revenues for all periods for continuing operations from external customers was attributed to sales in the United States.

For the three months ended March 31, 2010, two customers accounted for 11% and 10% of revenues from continuing operations. For the three months ended March 31, 2009, one customer accounted for 11% of revenues from continuing operations. For the six months ended March 31, 2010,

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three customers accounted for 14%, 11% and 10% of revenues from continuing operations. For the six months ended March 31, 2009, two customers accounted for 13% and 12% of revenues from continuing operations. No other customers accounted for more than 10% of revenues from continuing operations during these periods.

**Note 9. Loss per Share**

The following table presents the calculation of basic and diluted loss per share (*in thousands, except per share amounts*):

	Three months ended March 31, 2010	Six months ended March 31, 2010	Six months ended March 31, 2009
Loss from continuing operations	\$ (2,428)	\$ (43,612)	\$ (1,248)
Loss from discontinued operations, net of tax	(4,444)	(11,536)	(4,562)
Net loss	\$ (6,872)	\$ (55,148)	\$ (5,810)
 Basic and diluted loss per share from:			
Continuing operations	\$ (0.07)	\$ (1.53)	\$ (0.04)
Discontinued operations	\$ (0.13)	\$ (0.40)	\$ (0.13)
Net loss	\$ (0.20)	\$ (1.93)	\$ (0.17)
 Weighted average common shares outstanding:			
Basic and diluted	35,035	28,560	35,027
			28,465

Basic net earnings (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net earnings per share is computed using the weighted-average number of common and dilutive potential common shares outstanding during the period. Dilutive common-equivalent shares primarily consist of employee stock options computed using the treasury stock method. The treasury stock method assumes that proceeds from exercise are used to purchase common stock at the average market price during the period, which has the impact of reducing the dilution from options. Stock options will have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options. For periods in which the Company reports a net loss, diluted net loss per share is computed using the same number of shares as is used in the calculation of basic net loss per share because adding potential common shares outstanding would have an anti-dilutive effect.

The anti-dilutive weighted average shares that were excluded from the shares used in computing diluted net loss per share were approximately 7.7 million and 8.1 million for the three month periods ended March 31, 2010 and 2009, respectively, and were approximately 7.8 million and 7.7 million for the six month periods ended March 31, 2010 and 2009, respectively.

**Note 10. Stock-Based Compensation**

The Company has a stock-based compensation program that provides the Compensation Committee of its Board of Directors broad discretion in creating employee equity incentives. This program includes incentive stock options, non-statutory stock options and stock awards (also known as restricted stock or non-vested stock) granted under various plans and the majority of the plans have been approved by our stockholders. Certain of the Company's equity incentive grants have been issued pursuant to plans that were not approved by our stockholders in compliance with NASDAQ corporate governance rules. Options and awards granted pursuant to the Company's equity incentive plans

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typically vest over a four year period, although grants to non-employee directors are typically vested over a three year period. Options to non-employee directors granted prior to April 1, 2008 and certain

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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options granted during fiscal 2009 were fully vested on the date of grant. Additionally, the Company has an Employee Stock Purchase Plan ( "Purchase Plan" ) that allows employees to purchase shares of common stock at 85% of the fair market value at either the date of enrollment or the date of purchase, whichever is lower. As of March 31, 2010, the Purchase Plan program remains suspended as substantially all the shares under the Purchase Plan have been issued. Under the Company's stock plans, as of March 31, 2010, restricted share awards and option grants for 7.6 million shares of common stock were outstanding from prior awards and 3.9 million shares of common stock were available for future awards. The outstanding awards and grants as of March 31, 2010 had a weighted average remaining contractual life of 5.98 years and an aggregate intrinsic value of \$0.8 million. Of the options outstanding as of March 31, 2010, there were options exercisable for 3.8 million shares of common stock having a weighted average remaining contractual life of 4.15 years and an aggregate intrinsic value of approximately \$90,000.

As of March 31, 2010, there was \$7.8 million of unrecognized compensation cost related to outstanding stock options, net of forecasted forfeitures. This amount is expected to be recognized over a weighted average period of 2.84 years. To the extent the forfeiture rate is different from what the Company anticipated; stock-based compensation related to these options will be different from the Company's expectations.

Activity under the Company's stock option plans is summarized as follows:

	Number of Shares	Weighted Average Exercise Price	Remaining Contractual Life	Weighted Average
	<i>(per share)</i>		<i>(in years)</i>	Aggregate Intrinsic Value <i>(in thousands)</i>
Outstanding at September 30, 2009	7,820,610	\$ 6.96		
Options granted	1,677,325	2.80		
Options exercised	(2,000)	2.49		
Options canceled	(2,353,988)	6.72		
Outstanding at March 31, 2010	7,141,947	\$ 6.07	5.98	\$ 826
Exercisable at March 31, 2010	3,809,996	\$ 6.86	4.15	\$ 90

The Company had approximately 7.6 million and 8.0 million of options and awards outstanding as of March 31, 2010 and 2009, respectively.

The weighted-average grant-date fair value of equity options granted through the Company's stock option plans for the six months ended March 31, 2010 and 2009 are \$1.78 and \$1.97, respectively. The weighted-average grant-date fair value of equity options granted through the Company's Employee Stock Purchase Plan for the six months ended March 31, 2009 were \$1.33. The total intrinsic value of options exercised for the six months ended March 31, 2010 and 2009 are approximately \$2,000 and \$28,000, respectively.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Non-vested stock activity for the three and six months ended March 31, 2010 is summarized as follows:

	Three months ended March 31, 2010		Six months ended March 31, 2010	
	Non-vested Number of Shares	Weighted Average Grant-Date Fair Value ( <i>per share</i> )	Non-vested Number of Shares	Weighted Average Grant-Date Fair Value ( <i>per share</i> )
Nonvested stock at beginning of period	73,374	\$ 4.79	77,749	\$ 4.78
Granted	425,000	2.70	425,000	2.70
Vested	(62,520)	3.68	(66,895)	3.74
Forfeited	(12,500)	4.45	(12,500)	4.45
Nonvested stock at March 31, 2010	423,354	\$ 2.86	423,354	\$ 2.86

As of March 31, 2010, \$0.1 million of total unrecognized compensation costs related to non-vested awards was expected to be recognized over a weighted average period of 0.6 years.

**Note 11. Commitments and Contingencies**

**Leases**

The Company has commitments related to office facilities under operating leases. As of March 31, 2010, the Company had net commitments for \$7.8 million under non-cancelable operating leases with terms ranging from one to six years. The operating lease obligations also include (i) a facility in Norwood, Massachusetts which has been fully vacated and for which the Company entered into a sublease agreement in October 2008; and (ii) a facility in Milpitas, California, which has been partially vacated and for which the Company entered into a sublease agreement in November 2007. Further, as part of the restructuring activities carried out during fiscal year 2007, the Company is committed to pay approximately \$0.2 million related to facilities and certain other exit costs. See Note 5 Restructuring and Asset Impairment Charges for more information on the Company's restructuring plans. In addition, as of March 31, 2010, the Company is committed to pay approximately \$0.8 million for the assets acquired under capital lease arrangements. See Note 6 Property and Equipment, Net for the break-down of future minimum lease payments for assets acquired under capital lease arrangements together with the present value of the net minimum lease payments as of March 31, 2010.

As of March 31, 2010, future net minimum operating lease payments were as follows (*in thousands*):

Fiscal years ending September 30, 2010	\$ 1,675
2011	3,038
2012	2,483
2013	2,186
2014	202
Total minimum operating lease payments	9,585
Less: sublease rentals	(1,754)
Net minimum operating lease payments	\$ 7,831

**Litigation**

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The Company is subject to certain legal proceedings that arise in the normal course of its business. The Company believes that the ultimate amount of liability, if any, for pending claims of any

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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type (either alone or combined), including the legal proceeding described below, will not materially affect the Company's results of operations, liquidity, or financial position taken as a whole. However, actual outcomes may be materially different than anticipated.

*Phoenix Technologies Ltd v. DeviceVM, Inc.* On July 20, 2009, the Company filed a complaint in the Superior Court of California in Santa Clara County against DeviceVM, Inc., a privately held software company headquartered in San Jose, California (DeviceVM) and a former Phoenix employee. An amended complaint was subsequently filed on August 31, 2009. The lawsuit alleges trade secret theft and conversion of intellectual property assets by DeviceVM. The Company is seeking restitution, compensatory and punitive damages as well as a constructive trust. On October 1, 2009, the case was removed from Superior Court of California in Santa Clara County to the United States District Court for the Northern District of California. On December 10, 2009, DeviceVM filed counterclaims for false advertising, unfair competition and tortious interference with prospective economic advantage. On January 8, 2010, DeviceVM dismissed its claim for tortious interference with prospective economic advantage and added a claim for patent infringement. On February 4, 2010, the Company filed an additional complaint in the Northern District of California against DeviceVM for patent infringement, seeking damages and a court-ordered injunction. The Company does not believe that DeviceVM's counterclaims have merit and intends to defend itself vigorously.

**Note 12. Income Taxes**

The Company recorded an income tax expense of \$0.5 million and an income tax benefit of \$6.1 million for the three and six months ended March 31, 2010, respectively, as compared to an income tax expense of \$0.2 million and \$1.6 million for the three and six months ended March 31, 2009, respectively. The income tax benefit for the six months ended March 31, 2010 was comprised of the reduction in uncertain tax liabilities associated with the Taiwan tax settlement for the fiscal years 2000-2006 of \$5.2 million and a change in the measurement of uncertain tax positions in Taiwan for the fiscal years 2007-2009 of \$1.9 million, reduced by income tax expense related to foreign operations of \$1.0 million. The income tax expense for the six months ended March 31, 2009 was comprised of \$2.0 million related to foreign operations and state income taxes, reduced by \$0.2 million of income tax benefit related to an R&D credit refund and \$0.2 million related to the reduction of deferred tax liabilities associated with the impairment of goodwill and intangibles of companies acquired in the year ended September 30, 2008.

The income tax provision for the quarter ended March 31, 2010 was calculated based on the results of operations for the three and six months ended March 31, 2010 and does not reflect an annual effective rate. Since the Company cannot consistently predict its future operating income or in which jurisdiction it will be located, the Company is not using an annual effective tax rate to apply to the operating income for the quarter.

At the close of the most recent fiscal year, management determined that, based upon its assessment of both positive and negative evidence available, it was appropriate to continue to provide a full valuation allowance against any U.S. federal and U.S. state net deferred tax assets. As of March 31, 2010, the Company has deferred tax assets of \$78.6 million and it continues to be the assessment of management that a full valuation allowance against the U.S. federal and U.S. state net deferred tax assets is appropriate. A deferred tax asset amounting to \$0.2 million at March 31, 2010 remains recorded for the activities in Japan and Korea for which management has determined that no valuation allowance is necessary.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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Uncertain Tax Positions

The Company applies the provisions of FASB ASC 740, *Income Taxes*, to its uncertain tax positions. The total liability for uncertain tax positions as of September 30, 2009 excluding interest and penalties was \$23.0 million. During the six months ended March 31, 2010, the liability associated with uncertain tax positions decreased by \$8.5 million. This decrease was comprised of a reduction in the liability associated with the settlement with the TNTA covering the fiscal years 2000-2006 of \$8.5 million and a change in management's assessment of the uncertain tax positions in Taiwan covering the fiscal years 2007-2009 of \$1.9 million, offset by a reclassification of withholding taxes of \$1.2 million and the continued uncertain tax positions in foreign tax jurisdictions of \$0.7 million. Accordingly, the amount of unrecognized tax benefits as of March 31, 2010, excluding interest and penalties, was \$14.5 million.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (*in thousands*):

Gross balance at October 1, 2009	\$ 23,030
Additions based on tax positions related to current year	691
Reductions for tax positions taken in prior years	(9,167)
Gross balance at March 31, 2010	14,554
Interest and penalties	108
Balance at March 31, 2010	\$ 14,662

During fiscal year ended September 30, 2009, the Company submitted a proposal to the TNTA for a re-examination of the allocation of expenses under Taiwanese transfer pricing guidelines for fiscal years 2000 through 2006. During the three months ended December 31, 2009, the Company received final tax assessments from the TNTA in respect of each of these years that were in accordance with the proposal submitted by the Company. The assessments called for total tax and interest payments of approximately \$4.0 million, of which approximately \$1.9 million had previously been paid by the Company. Accordingly, during the three months ended December 31, 2009, the Company made cash payments to the TNTA totaling \$2.1 million in final settlement of its liabilities for taxes and related interest for these years. In accordance with its policies regarding the accounting for uncertain tax positions, the Company had previously recorded tax and interest expenses totaling approximately \$9.2 million for the relevant years. During the three months ended December 31, 2009, and as a result of the final assessment of \$4.0 million, the Company recorded a tax benefit relating to these years of approximately \$5.2 million.

During the three months ended December 31, 2009 and following the settlement with the TNTA for the 2000 through 2006 tax years, the Company reviewed its methodology associated with the measurement of the uncertain tax positions related to its transfer pricing exposure in Taiwan for the open tax years 2007 through 2009. The Company determined that, for the tax years 2007 through 2009, an exposure of \$4.6 million exists, which, as of March 31, 2010, has been fully reserved. The Company had previously recorded tax expenses totaling approximately \$6.5 million related to tax years 2007 through 2009. As a result of this change in measurement, the Company recorded a tax benefit of approximately \$1.9 million.

As of March 31, 2010, the Company continues to have tax exposure in Taiwan and other foreign jurisdictions. For the six months ended March 31, 2010, the Company recorded a liability for uncertain tax positions in Taiwan and other foreign jurisdictions of \$0.7 million. As of March 31, 2010, an aggregate exposure of \$9.2 million has been fully reserved. The Company believes that the reserves established for this exposure are adequate under the present circumstances.

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**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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The Company classifies interest and penalties related to uncertain tax positions in tax expense. The Company had \$0.1 million of interest and penalties accrued for the six months ended March 31, 2010.

The Company is subject to taxation in the U.S. and various states and foreign jurisdictions. The Company is no longer subject to routine examinations by foreign tax authorities for years before 2001 and is no longer subject to routine examinations by U.S. tax authorities for years before 2004.

**Note 13. Subsequent Events**

On April 7, 2010, the Company entered into an Asset Purchase Agreement ( APA ) with Absolute Software Corporation, a British Columbia corporation ( Absolute Software ), pursuant to which Absolute Software acquired all of the Company's rights, title and interests in certain intellectual property and other related assets of the Company's FailSafe and Phoenix Freeze products and services (the Purchased Assets ) for a purchase price of approximately \$6.9 million in cash. The Company also granted Absolute Software licenses for certain intellectual property excluded from the Purchased Assets in order for Absolute Software to use FailSafe, Freeze and other related products and services. The APA contains customary representations and warranties by the Company and Absolute Software. It also includes a non-competition provision under which the Company agreed not to engage in certain competitive activities relating to the Purchased Assets for a specified period following the execution of the Asset Purchase Agreement. The closing was completed on April 7, 2010.

On April 8, 2010, management of the Company approved a restructuring plan in connection with the sale of the intellectual property and other related assets of the Company's FailSafe and Phoenix Freeze products and services to Absolute Software on April 7, 2010. The Company expects to record a restructuring charge in the aggregate amount of approximately \$0.5 million in the third quarter of fiscal year 2010, all of which represents cash expenditures. The actions under this restructuring will involve terminating approximately 32 employees and vacating one of the Company's Bangalore, India facilities. It is estimated that the actions under this restructuring plan will be completed within the third quarter of fiscal year 2010.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion should be read in conjunction with our Condensed Consolidated Financial Statements and the related notes and other financial information appearing in this quarterly report.

**Overview**

We design, develop and support core system software ( CSS ) for personal computers ( PCs ) and other computing devices. Our CSS 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 our CSS products primarily to computer and component device manufacturers and we also provide these customers with training, consulting, maintenance and engineering services.

In the early 1980s, we established industry leadership by pioneering the design of the basic input-output system ( BIOS ), an early form of CSS that runs on most computing devices immediately after the device is powered on, during the period usually referred to as boot time. Today, the substantial majority of our revenues still come from our CSS brands, which include the SecureCore , TrustedCore , AwardCore , MicroCore and Embedded BIOS products. We design, develop, market, sell and support CSS products that initialize the chips and other components which are built into computing and communications devices and load the primary operating system in order to fully enable the operation of the device. We license our software products directly to the world's leading PC OEMs and ODMs, who incorporate these products during the device manufacturing process.

We also design, develop and support operating system software for PCs and other similar devices. HyperSpace , our operating system software, is a technology that significantly reduces the boot time of a PC by providing instant-on capabilities and conserves battery life. Our HyperCore product incorporates virtualization technologies which create or support virtual machines environments which enable multiple operating systems to run simultaneously on a single computer. Our Phoenix Flip™ product is a CSS plug-in technology that enables a device user to switch easily between two different operating systems on a single device.

We also offer eSupport, a suite of products and services generally delivered over the Internet which help users keep their computing devices both well-tuned and fully up-to-date for drivers and with respect to the operating system's registry.

During the first fiscal quarter of 2010, we announced a change to our business strategy to enable management to focus its attention on the Company's core competencies. To implement the new strategy, the Company announced the appointment of Thomas A. Lacey as its President and Chief Executive Officer and a member of its Board of Directors in February 2010. As part of this change in its business strategy, the Company intends to focus on the CSS markets in which Phoenix has a long-established leadership position. A substantial majority of the Company's revenues in fiscal years 2007, 2008 and 2009, and the first six months of fiscal year 2010 were derived from sales of CSS products and related services. As discussed below, the Company decided to sell the assets associated with its newer application-based products during the current quarter ended March 31, 2010.

Although the true consumers of the products and services that we offer are enterprises, governments and individuals, we typically sell these products through our OEMs, ODMs or service provider channels to enable brand managers, system designers and manufacturers across the entire PC industry to differentiate their systems, reduce time-to-market and thereby increase their revenues. In addition to licensing our products to OEM and ODM customers, we also sell certain of our products directly or indirectly to computer end users or support organizations through web-based delivery. We

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

derive additional revenues from providing development tools and support services such as customization, training, maintenance and technical support to our software customers and to various development partners.

Our revenues arise primarily from two sources:

1. License fees: revenues arising from agreements that license our software and other intellectual property rights to third parties. Primary license fee sources include: (1) CSS system firmware development platforms, firmware agents and firmware run-time licenses; (2) software development kits and software development tools; (3) device driver software; (4) embedded operating system software; and (5) embedded application software.
2. Service fees: revenues arising from agreements that provide for the delivery of professional engineering services. Primary service fee sources include software development, customization, deployment, support and training.

**Overview of Second Quarter Fiscal Year 2010 Results**

We recorded revenues of \$14.6 million during the three months ended March 31, 2010, which represents a decrease of \$0.5 million, or 3%, as compared to \$15.1 million recorded during the corresponding three months of our preceding fiscal year 2009. The decrease is mainly due to reduction in revenues derived from professional services and also due to the decrease recorded in both subscription and license fees as a result of an industry-wide decline in average selling prices, our loss of certain key customers and overall market share as well as our subsequent discontinuation of certain subscription based services offered during the second quarter of fiscal year 2009.

We recorded total expenditures (including operating expenses and cost of revenues) of \$16.5 million during the three months ended March 31, 2010, which compares to \$58.9 million recorded during the corresponding quarter of preceding fiscal year 2009 representing a net decrease of 72%, or \$42.3 million. The decrease is primarily due to reduction in aggregate impairment and amortization charges associated with acquired intangible assets by \$10.5 million, and to impairment charges incurred in the fiscal 2009 period associated with goodwill of \$23.9 million. The balance of the decrease is mainly due to the reduction in other operating costs as the Company implemented strategic cost management initiatives, as well as to the reversal of previously recognized stock-based compensation expense of \$2.6 million and to decreases in cost of revenues.

We recorded an after-tax loss of \$2.4 million and \$4.4 million from continuing operations and discontinued operations, respectively, which resulted in an overall net loss of \$6.9 million or (\$0.20) per share.

We ended our second fiscal quarter of 2010 with a cash and cash equivalents of \$25.3 million and used net cash of \$9.3 million in operating activities during the first six months of fiscal year 2010. The primary reasons that contributed to the use of cash for operating activities were the loss before income taxes of \$11.9 million (including that classified as discontinued operations) and the cash payments of \$2.1 million to the Taiwan National Tax Authority (the TNTA) during the first quarter of fiscal year 2010, offset by non-cash items and other working capital changes.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Our total order backlog as of March 31, 2010, comprised of unbilled volume purchase agreements ( "VPA") commitments and deferred revenue, was \$36.7 million, which represents a decrease of \$4.2 million, or 10%, from \$40.9 million as of December 31, 2009 and a decrease of \$4.3 million, or 11%, from \$41.0 million as of March 31, 2009. The decline is principally related to the fact that new contracts executed in the recent periods had lower pricing due to competitive pressures, compared to the contracts signed during the prior periods.

During the first fiscal quarter of 2010, we announced a change to our business strategy to enable management to focus its attention on the Company's core competencies. The strategy called for exploring strategic alternatives for the Company's FailSafe, Freeze, HyperSpace and eSupport products and services, including the possible divestiture or winding-down of these product lines. As part of this strategy, management decided to sell these assets during the current quarter and accordingly classified the assets and liabilities associated with these products and services as disposal groups "Held-for-Sale" as of March 31, 2010. In April 2010, we announced the completion of a sale of certain intellectual property and other related assets of our FailSafe and Freeze products and services, and the grant of licenses to certain other intellectual property related to the use of such products and services. In addition, the results of operations associated with eSupport products and services have been classified as discontinued operations for all periods presented. For a period of time up to the actual disposal, which is currently not expected to be greater than 12 months, the Company will continue to record cash inflows and outflows associated with eSupport products and services in its income statement as part of the discontinued operations. The Company currently does not expect continuation of cash flows after the consummation of any disposal transaction for eSupport disposal group. FailSafe, Freeze and HyperSpace products do not qualify as separate business operations, and related revenues and expenses therefore continue to be reflected in continuing operations. Unless noted otherwise, discussions in "Management's Discussion and Analysis of Financial Condition and Results of Operation" section pertain to continuing operations.

**Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations is based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with generally accepted accounting principles in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. We base our estimates and assumptions on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. On a regular basis we evaluate our estimates and assumptions and make necessary changes as warranted under the circumstances.

We believe that the estimates and assumptions involved in revenue recognition, valuation and impairment of goodwill and other long-lived intangible assets, allowances for accounts receivable, accounting for income taxes, stock-based compensation, retirement benefits, restructuring and asset impairment charges and fair value accounting have the greatest potential impact on our Financial Statements, so we consider these to be our critical accounting policies. Historically, our estimates and assumptions relative to our critical accounting policies have not differed materially from actual results. The critical accounting policies and estimates are described in detail in Item 7

"Management's Discussion and Analysis of Financial Condition and Results of Operation" of our Annual Report on Form 10-K for the fiscal year ended September 30, 2009. There have been no significant changes during the three and six months ended March 31, 2010 to these policies or the process followed to develop estimates.

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For a description of recent accounting pronouncements, see Note 1 Summary of Significant Accounting Policies in the Notes to Condensed Consolidated Financial Statements.

**Results of Operations**

The following table presents information regarding our results of continuing operations as a percentage of total consolidated revenues:

	Three months ended March 31, 2010	Six months ended March 31, 2010	Six months ended March 31, 2009
<b>Revenues:</b>			
License fees	86%	83%	86%
Subscription fees	<1%	<1%	<1%
Service fees	14%	16%	14%
Total revenues	100%	100%	100%
<b>Cost of revenues:</b>			
License fees	<1%	1%	1%
Subscription fees	<1%	1%	<1%
Service fees	13%	13%	12%
Amortization of purchased intangible assets	3%	5%	2%
Impairment of purchased intangible assets	<1%	69%	<1%
Total cost of revenues	16%	89%	15%
Gross margin	84%	11%	85%
<b>Operating expenses:</b>			
Research and development	53%	68%	55%
Sales and marketing	22%	34%	27%
General and administrative	17%	33%	25%
Restructuring and asset impairment	5%	6%	4%
Impairment of goodwill	<1%	158%	<1%
Total operating expenses	97%	299%	110%
Operating loss	(13)%	(289)%	(25)%
Interest and other income (expenses), net	(<1%)	1%	<1%
Loss from continuing operations before income taxes	(13)%	(288)%	(25)%
Income tax (benefit) expense	3%	1%	(21)%
			5%

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Loss from continuing operations	(17)%	(288)%	(4)%	(162)%
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\* *Certain percentages in the above table do not foot correctly due to the rounding*

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Revenues by geographic region for the three and six months ended March 31, 2010 and 2009 were as follows (*in thousands, except percentages*):

	Three months ended March 31,			Six months ended March 31,		
	2010	2009	% Change	2010	2009	% Change
<b>Revenues:</b>						
North America	\$ 3,633	\$ 3,283	11%	\$ 6,017	\$ 6,603	(9)%
Japan	2,649	3,126	(15)%	5,127	6,973	(26)%
Taiwan	6,151	6,859	(10)%	13,924	15,034	(7)%
Other Asian countries	1,780	1,019	75%	3,456	2,123	63%
Europe	431	855	(50)%	953	1,389	(31)%
Total revenues from continuing operations	14,644	15,142	(3)%	29,477	32,122	(8)%
Total revenues from discontinued operations	655	675		1,412	1,062	
<b>Total revenues</b>	<b>\$ 15,299</b>	<b>\$ 15,817</b>		<b>\$ 30,889</b>	<b>\$ 33,184</b>	

Substantially all of North America revenues for all periods for continuing operations from external customers was attributed to sales in the United States.

Total revenues from continuing operations for the three months ended March 31, 2010 were \$14.6 million, a decrease of \$0.5 million, or 3%, from revenues of \$15.1 million reported for the corresponding quarter of fiscal year 2009. Revenues for the second quarter of fiscal year 2010 for most geographic regions, with the exception of North America and Other Asian countries, decreased as compared to the same period in fiscal year 2009. Total revenues from continuing operations for the six months ended March 31, 2010 were \$29.5 million, a decrease of \$2.6 million, or 8%, from revenues of \$32.1 million reported for the same period of fiscal year 2009. Revenues for the first six months of fiscal year 2010 for most geographic regions, with the exception of Other Asian countries, decreased as compared to the same period in fiscal year 2009. The decline in revenue during the three and six months ended March 31, 2010 by 15% and 26%, respectively, from Japan is mainly due to the loss of two significant customers in the Japanese territory in the second half of fiscal year 2009. The decline in revenue in the three and six months ended March 31, 2010 by 10% and 7%, respectively, from Taiwan is mainly due to a combination of lower average selling prices as well as overall declines in shipments by our OEM and ODM customers and reduced service revenues from our VPA customers. The decrease in revenue during the three and six months ended March 31, 2010 by 50% and 31%, respectively, from Europe is mainly due to decreased revenue from one significant customer as a result of contract consolidation with its parent company located outside of the European territory. The increase in revenue during the three and six months ended March 31, 2010 by 75% and 63%, respectively, from Other Asian countries was mainly due to additional revenue generated from one significant customer in the Korean market. The increase in revenue during the three months ended March 31, 2010 by 11% from North America was mainly due to an overall increase in shipments by certain customers, while the decrease of 9% from the same region during the six months ended March 31, 2010 was primarily attributable to decreased royalties received from certain Pay as You Go customers due to lower shipments mainly during the first quarter of fiscal year 2010.

Revenues by sources for the three and six months ended March 31, 2010 and 2009 were as follows (*in thousands, except percentages*):

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	Three months ended March 31,			Six months ended March 31,		
	2010	2009	% Change	2010	2009	% Change
License revenues	\$ 12,563	\$ 12,628	(1)%	\$ 25,451	\$ 27,112	(6)%
Subscription revenues	7	67	(89)%	8	129	(94)%
Service revenues	2,074	2,447	(15)%	4,018	4,881	(18)%
Total revenues	\$ 14,644	\$ 15,142	(3)%	\$ 29,477	\$ 32,122	(8)%

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License fees for the three months ended March 31, 2010 were \$12.6 million, a marginal decrease of less than \$0.1 million, or 1%, from \$12.6 million recorded for the same period in fiscal year 2009. As a percentage of consolidated revenues, license revenues in the three months ended March 31, 2010 were 86% versus 83% in the same period in fiscal year 2009.

License fees for the six months ended March 31, 2010 were \$25.5 million, a decrease of \$1.7 million, or 6%, from \$27.1 million recorded for the same period in fiscal year 2009. As a percentage of consolidated revenues, license revenues in the six months ended March 31, 2010 were 86% versus 84% in the same period in fiscal year 2009.

The decrease in license fees during the first six months of fiscal year 2010 is primarily due to an industry-wide decline in average selling prices and the loss of two key customers in the Japan region in the second half of fiscal year 2009.

During the three and six months ended March 31, 2010, we recognized subscription fee revenues of approximately \$7,000 and \$8,000, respectively. The subscription revenues associated with the sale of eSupport products and services amounting to approximately \$0.7 million and \$1.4 million for the three and six months ended March 31, 2010, respectively, have been reclassified and reported under Loss from discontinued operations, net of tax. During the three and six months ended March 31, 2009, we recognized subscription fee revenues of approximately \$67,000 and \$129,000, respectively. The subscription revenues associated with the sale of eSupport products and services amounting to approximately \$0.7 million and \$1.1 million for the three and six months ended March 31, 2009, respectively, have been reclassified and reported under Loss from discontinued operations, net of tax.

Service fees for the three months ended March 31, 2010 were \$2.1 million, a decrease of approximately \$0.4 million, or 15%, from \$2.4 million for the same period in fiscal year 2009. As a percentage of consolidated revenues, service fees were 14% in the current quarter of fiscal year 2010 versus 16% for the same period in the previous fiscal year 2009. Service fees for the six months ended March 31, 2010 were \$4.0 million, a decrease of approximately \$0.9 million, or 18%, from \$4.9 million for the same period in fiscal year 2009. As a percentage of consolidated revenues, service fees were 14% for the first six months of fiscal year 2010 versus 15% for the same period in the previous fiscal year 2009. The decrease in revenues associated with service fees during the three and six months ended March 31, 2010 was primarily the result a decreased number of support service days sold to our customers due to lower shipments and loss of overall market share.

**Cost of Revenues**

Cost of revenues for the three and six months ended March 31, 2010 and 2009 were as follows (*in thousands, except percentages*):

	Three months ended March 31,			Six months ended March 31,		
	2010	2009	% Change	2010	2009	% Change
Cost of revenues	2,288	13,521	(83)%	4,338	16,657	(74)%
Percent of consolidated revenue	16%	89%		15%	52%	

Cost of revenues mainly consists of third party license fees, service fees and amortization and impairment of purchased intangible assets. License fees are primarily third party royalty fees, electronic product fulfillment costs and the costs of product labels for customer use. Service fees include personnel-related expenses such as salaries and other related costs associated with work performed under professional service contracts, non-recurring engineering agreements and post-sales customer support costs.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Cost of revenues decreased by approximately \$11.2 million, or 83%, from \$13.5 million in the three months ended March 31, 2009, to \$2.3 million in the three months ended March 31, 2010. Of the \$11.2 million decrease, \$10.9 million was associated with the impairment and additional amortization charges recorded on purchased intangibles assets in the quarter ended March 31, 2009. The other decrease of \$0.3 million was associated with lower cost of revenues recognized on all other streams of revenues.

Cost of revenues decreased by approximately \$12.3 million, or 74%, from \$16.7 million in the six months ended March 31, 2009, to \$4.3 million in the six months ended March 31, 2010. Of the \$12.3 million decrease, \$11.5 million was associated with the impairment and additional amortization charges recorded on purchased intangibles assets during the first six months of fiscal year 2009. The other decrease of \$0.8 million was associated with lower cost of revenues recognized on all other streams of revenues, mainly service fees where cost of revenues decreased by \$0.5 million due to the decrease in associated service fees revenues.

**Research and Development Expenses**

Research and development expenses for the three and six months ended March 31, 2010 and 2009 were as follows (*in thousands, except percentages*):

	Three months ended March 31,			Six months ended March 31,		
	2010	2009	% Change	2010	2009	% Change
Research and development	7,697	10,313	(25)%	16,121	20,781	(22)%
Percent of consolidated revenue	53%	68%		55%	65%	

Research and development expenses consist primarily of salaries and other related costs for research and development personnel, quality assurance personnel, product localization expense, fees to outside contractors, facilities and IT support costs and depreciation of capital equipment.

Research and development expenses decreased by \$2.6 million, or 25%, to \$7.7 million for the three months ended March 31, 2010, from \$10.3 million for the same period in fiscal year 2009. The decrease was principally due to decreases in payroll and related benefit expenses of \$1.3 million, which is in line with the reduction in the number of engineering and engineering management personnel from 367 to 280, a reduction in stock-based compensation expense by \$0.3 million, decreased consulting fees of \$0.4 million related mainly to the reduction in use of consultants for research and development activities, decreased travel expenses and recruitment fee of \$0.1 million each and a reduction in certain other overhead expenses by \$0.4 million.

Research and development expenses decreased by \$4.7 million, or 22%, to \$16.1 million for the six months ended March 31, 2010, from \$20.8 million for the same period in fiscal year 2009. The decrease was principally due to decreases in payroll and related benefit expenses of \$2.2 million due to reduction in the number of engineering and engineering management personnel, a reduction in stock-based compensation expense by \$0.7 million, decreased consulting fees of \$1.3 million related mainly to the reduction in use of consultants, decreased travel expenses and recruitment fee aggregating to \$0.4 million and a reduction in certain other overhead expenses by \$0.1 million.

Despite the decrease in revenues, research and development expenditures declined as a percentage of consolidated revenues by 15 percentage points in the current quarter and 10 percentage points in the six months ended March 31, 2010 due to the decreased spending described above. Due to our decision to divest products and services related to FailSafe, Freeze and HyperSpace, we expect

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research and development expenses to further decrease in absolute dollars for the remaining quarters of fiscal year 2010.

**Sales and Marketing Expenses**

Sales and marketing expenses for the three and six months ended March 31, 2010 and 2009 were as follows (*in thousands, except percentages*):

	Three months ended March 31,			Six months ended March 31,		
	2010	2009	% Change	2010	2009	% Change
Sales and marketing	3,268	5,218	(37)%	7,973	10,141	(21)%
Percent of consolidated revenue	22%	34%		27%	32%	

Sales and marketing expenses consist primarily of salaries, commissions, travel and entertainment, facilities and IT support costs, promotional expenses (marketing and sales literature) and marketing programs, including advertising, trade shows and channel development. Sales and marketing expenses also include costs relating to technical support personnel associated with pre-sales activities such as performing product and technical presentations and answering customers' product and service inquiries.

Sales and marketing expenses decreased by \$2.0 million, or 37%, to approximately \$3.3 million for the three months ended March 31, 2010 from \$5.2 million for the same period in the previous fiscal year. The decrease was principally due to reduction in spending on marketing campaigns and other related expenses of \$1.2 million, decreased payroll and related benefit expenses of \$0.6 million, which is in line with the reduction in the number of sales and marketing personnel from 59 to 48, and a decrease in certain other sales and marketing related overhead expenses by \$0.2 million.

Sales and marketing expenses decreased by \$2.2 million, or 21%, to approximately \$8.0 million for the six months ended March 31, 2010 from \$10.1 million for the same period in the previous fiscal year. The decrease was principally due to reduction in spending on marketing campaigns and other related expenses by \$1.2 million, decreased payroll and related benefit expenses of \$0.3 million, reduction in consulting fees of \$0.2 million and a decrease in certain other sales and marketing related overhead expenses by \$0.5 million.

The decrease of 12 percentage points for the current quarter and five percentage points for the six months ended March 31, 2010 in sales and marketing expenses as a percentage of consolidated revenues as compared to the same periods in the prior fiscal year was a result of decreased spending described above. Due to our decision to divest products and services related to FailSafe, Freeze and HyperSpace, we expect sales and marketing expenses to further decrease in absolute dollars for the remaining quarters of fiscal year 2010.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****General and Administrative Expenses**

General and administrative expenses for the three and six months ended March 31, 2010 and 2009 were as follows (*in thousands, except percentages*):

	Three months ended March 31,			Six months ended March 31,		
	2010	2009	% Change	2010	2009	% Change
General and administrative	2,533	4,987	(49)%	7,222	10,607	(32)%
Percent of consolidated revenue	17%	33%		25%	33%	

General and administrative expenses consist primarily of salaries and other costs relating to administrative, executive and financial personnel and outside professional fees, including those associated with audit and legal services.

General and administrative expenses decreased by \$2.5 million, or 49%, to \$2.5 million for the three months ended March 31, 2010 from \$5.0 million for the same period in the previous fiscal year. The decrease was primarily related to reduction in payroll and related benefit expenses of \$2.8 million associated mainly with a reversal of previously recognized stock-based compensation cost of \$2.6 million for certain awards based on market conditions, reduction in outside recruiting fees of \$0.2 million partially offset by a \$0.5 million net increase in other general and administration expenditures.

General and administrative expenses decreased by \$3.4 million, or 32%, to \$7.2 million for the six months ended March 31, 2010 from \$10.6 million for the same period in the previous fiscal year. The decrease was primarily related to reduction in payroll and related benefit expenses of \$3.3 million (including the reversal of certain stock-based compensation cost described above), reduction in outside consulting and recruiting fees by \$0.3 million and \$0.2 million, respectively, partially offset by a \$0.4 million net increase in other general and administration expenditures.

Despite the reduction in revenues, a decrease in general and administrative expense as a percentage of consolidated revenues by 16 percentage points for the current quarter and eight percentage points for the six months ended March 31, 2010 as compared to the same period in the prior fiscal year was a result of decreased spending as described above. Although our decision to divest in products and services related to FailSafe, Freeze and HyperSpace would result in decreased expenditure, due to the non-recurring nature of the stock-based compensation benefit recognized during the current quarter; we expect general and administrative expenses to slightly increase in absolute dollars for the remaining quarters of fiscal 2010.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Restructuring and Asset Impairment**

In response to the challenging global economic environment and with a view to better align and consolidate the Company's development activities, in October 2009 management approved the closure of the Company's facility in Nanjing, China. The actions under this restructuring plan involved terminating or relocating approximately 34 employees to the Company's other locations and vacating the Nanjing facility. In addition, in January 2010, a restructuring plan was approved for the purpose of reducing future operating expenses by eliminating 37 employee positions. During the three months and six months period ended March 31, 2010, we recorded approximately \$0.8 million and \$1.2 million, respectively, as charges associated with the above referred restructuring plans as well as certain true-up adjustments recorded in relation to the plans announced during the prior periods. The restructuring charges are principally associated with severance and employee relocation costs, asset impairments and certain other exit costs. See Note 5 Restructuring and Asset Impairment Charges in the Notes to Condensed Consolidated Financial Statements for more information on our restructuring plans.

**Interest and Other Income (Expenses), Net**

Net interest and other income (expenses) for the three and six months ended March 31, 2010 and 2009 were as follows (*in thousands, except percentages*):

	Three months ended March 31,			Six months ended March 31,		
	2010	2009	% Change	2010	2009	% Change
Interest and other income (expenses), net	(41)	335	(112)%	107	605	(82)%
Percent of consolidated revenue	<1%	2%		<1%	2%	

Net interest and other income (expenses) consists mostly of interest income, which is primarily derived from cash equivalents, foreign exchange transaction gains and losses, losses/gains on disposal of assets, interest expenses and other miscellaneous expenses/income.

We incurred approximately \$41,000 in net interest and other expenses for the quarter ended March 31, 2010 as compared to a net income of \$0.3 million earned during the corresponding quarter of fiscal year 2009, resulting in a net change of approximately \$0.4 million. For the six months ended March 31, 2010, we earned \$0.1 million in net interest and other income as compared to \$0.6 million for the same period of fiscal year 2009, representing an approximate decrease of \$0.5 million. This reduction in income resulted primarily from increase in net foreign exchange losses related mainly to depreciation of the U.S. Dollar to the New Taiwan Dollar and other international currencies to which the Company has exposure.

**Provision for Income Taxes**

Income tax (benefit) expense for the three and six months ended March 31, 2010 and 2009 were as follows (*in thousands, except percentages*):

	Three months ended March 31,			Six months ended March 31,		
	2010	2009	% Change	2010	2009	% Change
Income tax (benefit) expense	490	221	122%	(6,058)	1,620	(474)%
Percent of consolidated revenue	3%	1%		(21%)	5%	

We recorded an income tax expense of \$0.5 million for the three months ended March 31, 2010, a net change of approximately \$0.3 million, or 122%, from \$0.2 million recorded for the same period in fiscal year 2009. The net change of income tax expense is primarily associated with the income tax benefit of \$0.5 million related to deferred

tax liabilities on the impairment of goodwill and intangibles

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of the companies acquired in the year ended September 30, 2008 and of \$0.1 million related to an R&D credit refund for the quarter ended March 31, 2009; offset by the reduction of the liability for uncertain tax positions of \$0.3 million for the quarter ended March 31, 2010.

The \$0.5 million income tax expense for the three months ended March 31, 2010 is primarily due to income taxes from foreign operations.

We recorded an income tax benefit of \$6.1 million for the six months ended March 31, 2010, a net change of approximately \$7.7 million, or 474%, from the expense of \$1.6 million recorded for the same period in fiscal year 2009. The change is primarily associated with the reduction in uncertain tax liabilities associated with the Taiwan tax settlement as described in Note 12 Income Taxes in the Notes to Condensed Consolidated Financial Statements.

The \$6.1 million income tax benefit for the six months ended March 31, 2010 is due to the removal of liabilities for uncertain tax positions of \$7.1 million, comprised of \$5.2 million for the fiscal years 2000 through 2006 and \$1.9 million for the fiscal years 2007 through 2009, offset by income tax expense of \$1.0 million recorded for the six months ended March 31, 2010 in relation to the Company's foreign operations.

The income tax expense for the quarter was calculated based on the results of operations for the three months ended March 31, 2010 and does not reflect an annual effective rate. Since we cannot consistently predict our future operating income or in which jurisdiction such income will be located, we do not use an annual effective tax rate to apply to the operating income for the quarter.

**Loss from Discontinued Operations, Net of Tax**

As of March 31, 2010, the results of operations associated with eSupport products and services have been classified as discontinued operations for all periods presented. The following table presents the revenues and other components of the amounts included under Loss from discontinued operations, net of tax (in thousands):

	Three months ended March 31,		Six months ended March 31,	
	2010	2009	2010	2009
Revenues	\$ 655	\$ 675	\$ 1,412	\$ 1,062
<b>Expenses:</b>				
Impairment of goodwill, tangible and intangible assets, and costs to sell	\$ 4,289	\$ 10,801	\$ 4,289	\$ 10,801
Other costs	810	1,410	1,685	2,751
Total expenses	\$ 5,099	\$ 12,211	\$ 5,974	\$ 13,552
Loss from discontinued operations, net of tax	\$ (4,444)	\$ (11,536)	\$ (4,562)	\$ (12,490)

**Acquisitions**

We did not acquire any businesses in fiscal year 2009 or the first half of fiscal year 2010. In fiscal year 2008, we acquired three business entities all of which were accounted for in accordance with the authoritative accounting pronouncements for Business Combinations.

Although we have no current plans, commitments or agreements with respect to any acquisitions, we expect to continue to evaluate possible acquisitions of, or strategic investments in, businesses, products and technologies that are complementary to our business, which may require the use of cash. Future acquisitions could cause amortization expenses to increase. In addition, if



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impairment events occur, such as that arising during the current quarter related to the Company's discontinued operations, they could also accelerate the timing of charges.

**Financial Condition**

At March 31, 2010, our principal source of liquidity consisted of cash and cash equivalents totaling \$25.3 million compared to cash and cash equivalents totaling \$22.6 million at March 31, 2009 and \$35.1 million at the end of fiscal year 2009.

During the six months ended March 31, 2010, cash decreased by \$9.7 million mainly as a result of \$9.3 million used in operating activities, \$0.4 million used in financing activities and \$0.3 million used in investing activities, partially offset by \$0.2 million increase due to the effect of changes in currency exchange rates. Net cash of \$9.3 million used in operating activities consisted of net loss of \$5.8 million adjusted for non-cash items including depreciation, amortization, stock-based compensation expense, loss from disposal/impairment of fixed assets and impairment of purchased intangible assets and goodwill aggregating to \$6.7 million offset by a net change in working capital to the extent of \$10.2 million. The net changes in working capital and other activities related primarily to: (a) a \$10.4 million decrease in income taxes payable as the Company made cash payments of \$2.1 million to the TNTA and adjusted liabilities of \$7.1 million for uncertain tax positions related to its operations in Taiwan during the first quarter ended December 31, 2009; (b) a \$4.9 million decrease in deferred revenue mainly driven by lower billings during the current period; and (c) a net decrease of \$0.3 million in accounts payable, partially offset by (i) a \$1.9 million decrease in accounts receivable as the Company was able to collect outstanding debts from some of its large customers; (ii) a \$2.7 million reduction in other assets mainly driven by adjustment of prepaid taxes of \$1.9 million towards the amounts due to be paid under the final tax assessments for fiscal years 2000 through 2006 received from the TNTA during the first quarter of fiscal year 2010; and (iii) an aggregate change of approximately \$0.9 million in restructuring and other accrued liabilities.

Cash used in investing activities was due to purchases of property and equipment of \$0.3 million, while cash of \$0.4 million was used in financing activities mainly for principal payments made under capital lease obligations and repurchases of common stock.

At March 31, 2009, our principal source of liquidity consisted of cash and cash equivalents totaling \$22.6 million. During the six months ended March 31, 2009, cash decreased by \$15.1 million mainly as a result of \$14.0 million and \$1.7 million used in operating activities and investing activities, respectively, and a \$0.1 million decrease due to the effect of changes in currency exchange rates. These cash uses were offset by cash of \$0.7 million provided by financing activities. Cash used in operating activities was primarily due to the net loss of \$64.4 million adjusted for non-cash items such as depreciation, amortization, impairment of purchased intangible assets and goodwill and stock-based compensation expense aggregating to \$53.7 million. In addition, cash used in operations to the extent of \$3.3 million was attributed to the changes in operating assets and liabilities related primarily to a \$1.2 million increase in accounts receivable, due in part to delay in receipt of a payment from a large customer; \$1.9 million and \$0.9 million decrease in accrued compensation and related liabilities and other accrued liabilities, respectively, primarily due to payment of bonuses to employees based on the Company's performance for fiscal year 2008; \$0.6 million decrease in other operating assets and liabilities which was partially offset by a \$1.3 million increase in deferred revenue mainly driven by higher prepayments received and lower revenue generated from our VPA arrangements. Cash used in investing activities was due to purchases of property and equipment and other intangible assets of \$1.5 million and additional acquisitions related costs of \$0.2 million, while cash of \$0.7 million provided by financing activities was mainly due to proceeds from stock issuances under stock option and stock purchase plans, net of repurchases.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Subsequent to the quarter-end, on April 7, 2010, the Company entered into an Asset Purchase Agreement ( APA ) with Absolute Software Corporation, a British Columbia corporation ( Absolute Software ), pursuant to which Absolute Software acquired all of the Company's rights, title and interests in certain intellectual property and other related assets of the Company's FailSafe and Phoenix Freeze products and services for a purchase price of approximately \$6.9 million in cash.

We believe that our current cash and cash equivalents and the cash we expect to generate from future operations, including the cash generated through the sale of FailSafe and Freeze products subsequent to the quarter-end referred above, will be sufficient to meet our operating and capital requirements for at least the next twelve months. However, there are a number of factors that could impact our liquidity position, including, but not limited to:

- (i) implementation of our new business strategy to focus on the CSS markets in which Phoenix has a long-established leadership position;
- (ii) global economic conditions which might affect demand for our products and services and impact the financial stability of our suppliers and customers;
- (iii) the possibility that certain customers may delay payments to manage their own liquidity positions;
- (iv) plans to further restructure our business and operations; and
- (v) possible investments or acquisitions of complementary businesses, products or technologies, although we have no current plans, commitments or agreements with respect to any acquisitions.

It is reasonably possible that we will incur a net loss and continue to have negative net cash flows in the remaining quarters of fiscal year 2010, which would be exacerbated if we are unable to achieve the revenues we anticipate or if we are unable to effectively manage our cash expenditures. We may need to raise additional capital to fund our operations, and there is no guarantee that such capital will be available at terms acceptable to us or at all.

**Commitments**

As of March 31, 2010, we had net commitments for \$7.8 million under non-cancelable operating leases with terms ranging from one to six years. The operating lease obligations include (i) a facility in Norwood, Massachusetts which has been fully vacated and for which the Company entered into a sublease agreement in October 2008; and (ii) a facility in Milpitas, California, which has been partially vacated and for which the Company entered into a sublease agreement in November 2007. Further, as part of the restructuring activities carried out during fiscal year 2007, we are committed to pay approximately \$0.2 million related to facilities and certain other exit costs. See Note 5 Restructuring and Asset Impairment Charges in the Notes to Condensed Consolidated Financial Statements for more information on our restructuring plans. In addition, as of March 31, 2010, we are committed to pay approximately \$0.8 million for the assets acquired under capital lease arrangements.

**Outlook**

Based on past performance and current expectations, we believe that current cash and cash equivalents on hand and cash we expect to generate from operations in future periods, will satisfy our working capital, capital expenditures, commitments and other liquidity requirements associated with our existing operations through at least the next twelve months. It is reasonably possible that we will incur a

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

net loss and continue to have negative net cash flows in the remainder of fiscal year 2010, which would be exacerbated if we are unable to achieve the revenues we anticipate or if we are unable to effectively manage our cash expenditures. We regularly assess our cash management approach and activities in view of our current and potential future needs. There are currently no transactions or arrangements that are reasonably likely to adversely affect liquidity or the availability of our requirements for capital. Investment in new product initiatives and businesses or future acquisitions may require us to seek additional funding sources beyond our current balances of cash and cash equivalents.

**Available Information**

Our website is located at [www.phoenix.com](http://www.phoenix.com). Through a link on the Investor Relations section of our website, we make available the following and other 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 Quarterly Report or in to any of our other filings with the SEC.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We believe there has been no material change in our exposure to market risk from that discussed in our fiscal year 2009 Annual Report filed on Form 10-K.

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**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our Chief Executive Officer and Chief Financial Officer have reviewed, as of the end of the period covered by this quarterly report, the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), which are designed to ensure that information relating to the Company that is required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Exchange Act and related regulations. Based on this review, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of March 31, 2010, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

During our most recent fiscal quarter, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

We are subject to certain legal proceedings that arise in the normal course of our business. We believe that the ultimate amount of liability, if any, for any pending claims of any type (either alone or combined), including the legal proceeding described below, will not materially affect our results of operations, liquidity, or financial position taken as a whole. However, actual outcomes may be materially different than anticipated.

*Phoenix Technologies Ltd v. DeviceVM, Inc.* On July 20, 2009, the Company filed a complaint in the Superior Court of California in Santa Clara County against DeviceVM, Inc., a privately held software company headquartered in San Jose, California ( DeviceVM ) and a former Phoenix employee. An amended complaint was subsequently filed on August 31, 2009. The lawsuit alleges trade secret theft and conversion of intellectual property assets by DeviceVM. The Company is seeking restitution, compensatory and punitive damages as well as a constructive trust. On October 1, 2009, the case was removed from Superior Court of California in Santa Clara County to the United States District Court for the Northern District of California. On December 10, 2009, DeviceVM filed counterclaims for false advertising, unfair competition and tortious interference with prospective economic advantage. On January 8, 2010, DeviceVM dismissed its claim for tortious interference with prospective economic advantage and added a claim for patent infringement. On February 4, 2010, the Company filed an additional complaint in the Northern District of California against DeviceVM for patent infringement, seeking damages and a court-ordered injunction. The Company does not believe that DeviceVM's counterclaims have merit and intends to defend itself vigorously.

**ITEM 1A. RISK FACTORS**

We believe there has been no material change in the risk factors related to our business from those set forth in Item 1A of Part I of our Annual Report filed on Form 10-K for the fiscal year ended September 30, 2009 and in Item 1A of Part II of our Form 10-Q for the three-month period ended December 31, 2009.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

During the quarter ended March 31, 2010, we withheld 27,195 shares of our common stock for a total value of approximately \$81,000, from the restricted stock grants held by various employees for purposes of covering the payroll taxes on the vested portions of such employees' restricted stock grants. Our restricted stock agreements allow for the Company to withhold, at the election of the employee, the appropriate number of shares to cover applicable taxes upon vesting (in lieu of the employee paying cash to cover such taxes).

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**Table of Contents****ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Removed and reserved.

**ITEM 5. OTHER INFORMATION**

The Company held its Annual Meeting of Stockholders on February 3, 2010, at which the following occurred:

**ELECTION OF DIRECTORS TO THE BOARD OF DIRECTORS OF THE COMPANY**

The stockholders elected director nominees Jeffrey Smith, Douglas Barnett, Dale Fuller, Woodson Hobbs, Patrick Little, Richard Noling, Edward Terino, Kenneth Traub and Mitchell Tuchman to the Board of Directors of the Company. The vote on the matter was as follows:

	For	Against	Abstain
Jeffrey Smith	25,371,537	404,661	60,833
Douglas Barnett	17,992,460	7,785,015	59,556
Dale Fuller	25,272,159	502,725	62,147
Woodson Hobbs	18,470,337	7,318,109	48,585
Patrick Little	25,279,024	488,632	69,375
Richard Noling	18,472,130	7,306,358	58,543
Edward Terino	24,793,176	971,773	72,082
Kenneth Traub	24,699,076	1,077,773	60,182
Mitchell Tuchman	17,951,434	7,827,154	58,443

**RATIFICATION OF THE APPOINTMENT OF ERNST & YOUNG LLP**

The stockholders ratified the appointment of Ernst & Young LLP by the Audit Committee of the Board of Directors as the Company's independent registered public accounting firm for the fiscal year ending September 30, 2010. The vote on the matter was as follows:

For	Against	Abstain
32,486,485	67,173	146,483

**APPROVAL OF AMENDMENT TO 2007 EQUITY INCENTIVE PLAN**

The stockholders approved an amendment to the Company's 2007 Equity Incentive Plan (the "2007 Plan") to increase the number of shares issuable under the 2007 Plan by 1,500,000 shares. The vote on the matter was as follows:

For	Against	Abstain
13,546,739	10,815,956	1,474,336

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**ITEM 6. EXHIBITS**

- 10 .1 Offer Letter for Thomas Lacey dated February 25, 2010.
- 10.2 Stock Option Agreement dated February 25, 2010 between the Company and Thomas Lacey.
- 10.3 2008 Acquisition Equity Incentive Plan Restricted Stock Purchase Agreement dated February 25, 2010 between the Company and Thomas Lacey.
- 10.4 Severance and Change of Control Agreement dated February 25, 2010 between the Company and Thomas Lacey.
- 10.5 Form of Indemnity Agreement between the Company and Thomas Lacey.
- 10.6 Severance and Change of Control Agreement dated September 2, 2008 between the Company and Robert Andersen.
- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350.
- 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**PHOENIX TECHNOLOGIES LTD.**

By: /s/ THOMAS A. LACEY  
Thomas A. Lacey  
President and Chief Executive Officer  
Date: May 7, 2010

By: /s/ ROBERT J. ANDERSEN  
Robert J. Andersen  
Chief Financial Officer  
Date: May 7, 2010

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**EXHIBIT INDEX**

**Exhibit**

**Number Description**

- 10.1 Offer Letter for Thomas Lacey dated February 25, 2010.
- 10.2 Stock Option Agreement dated February 25, 2010 between the Company and Thomas Lacey.
- 10.3 2008 Acquisition Equity Incentive Plan Restricted Stock Purchase Agreement dated February 25, 2010 between the Company and Thomas Lacey.
- 10.4 Severance and Change of Control Agreement dated February 25, 2010 between the Company and Thomas Lacey.
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