SONA MOBILE HOLDINGS CORP
Form 10QSB
May 14, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934.
FOR THE TRANSITION PERIOD FROM To .

Commission File Number 000-12817

SONA MOBILE HOLDINGS CORP.
(Name of small business issuer in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-3087593 (I.R.S. Employer Identification No.)

245 Park Avenue, New York, New York 10167
(Address of principal executive office)

(212) 486-8887
(Issuer’s telephone number, including area code)

Securities registered under Section 12(b) of the Exchange Act:

None (Title of Each Class)	None (Name of each Exchange on Which Registered)

Securities registered under Section 12(g) of the Exchange Act:

Common Stock
(Title of Class)

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 45 days. Yes No

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

The number of shares outstanding of the registrant's Common Stock, $0.01 par value, as of May 11, 2007 was 57,777,857 shares.

Transitional Small Business Disclosure Format. Yes No

SONA MOBILE HOLDINGS CORP.

FORM 10-QSB REPORT
March 31, 2007

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FORWARD-LOOKING STATEMENTS

Certain statements made in this Quarterly Report on Form 10-QSB are ''forward-looking statements'' regarding the plans and objectives of management for future operations and market trends and expectations. The words ''expect,'' ''believe,'' ''plan,'' ''intend,'' ''estimate,'' ''anticipate,'' ''propose,'' ''seek'' and similar words and variations thereof, when used, are in specifically identify forward-looking statements. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties, including but not limited to those set forth in our Registration Statement on Form SB-2, as amended and filed with the SEC on April 3, 2007. Our plans and objectives are based, in part, on assumptions involving the continued expansion of our business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, we cannot assure you that the forward-looking statements included in this report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. We do not undertake any obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof.

The terms the ''Company'', ''Sona'', ''we'', ''our'', ''us'', and derivatives thereof, as used herein refer to Sona Mobile Holdi
Corp., a Delaware corporation, and its subsidiaries and its predecessor, Sona Mobile, Inc., a Washington corporation.

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PART I
FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements
Sona Mobile Holdings Corp. And Subsidiaries
Consolidated Balance Sheet

	At March 31, 2007 (unaudited)
Assets	
Current:	
Cash and cash equivalents	$ 4,191,026
Accounts receivable (net of allowance for doubtful accounts of $25,769)	168,887
Tax credits receivable	43,975
Prepaid expenses & deposits	85,216
Total current assets	4,489,104
Property and equipment:	
Computer equipment	106,752
Furniture and equipment	66,811
Less: accumulated depreciation	(68,213)
Total property and equipment	105,350
Software development costs (Note 3(i))	77,546
Total Assets	$ 4,672,000
Liabilities and Stockholders' Equity	
Current:	
Accounts payable	$ 422,107
Accrued liabilities & payroll (Note 13)	379,115

Deferred revenue (Note 14)	451,340
Total current liabilities	1,252,562
Total Liabilities	1,252,562
Stockholders' equity:	
Preferred Stock – 2,000,000 shares authorized, par value $.01 per share – no shares issued and outstanding	—
Common Stock – 90,000,000 shares authorized, par value $.01 per share – 57,777,857 shares issued and outstanding	577,778
Additional paid-in capital	15,800,323
Common Stock purchase warrants	4,734,965
Unamortized stock based compensation	(15,403)
Accumulated other comprehensive (loss)	(49,795)
Accumulated deficit	(17,628,430)
Total stockholders' equity	3,419,438
Total Liabilities and Stockholders' Equity	$ 4,672,000

See accompanying notes to consolidated financial statements.

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Item 1. Consolidated Financial Statements (Continued)
Sona Mobile Holdings Corp. and Subsidiaries
Consolidated Statements of Operations and Comprehensive Loss

	Three months ended March 31,	
	2007 (unaudited)	2006 (unaudited)
Net Revenue	$ 148,127	$ 125,324
Operating expenses		
Depreciation and amortization	12,285	7,837
General and administrative expenses	545,590	573,053
Professional fees	397,459	297,906
Development expenses	545,047	383,665
Selling and marketing expenses	346,268	1,300,984
Total operating expenses	1,846,649	2,563,445
Operating loss	(1,698,522)	(2,438,121)
Interest income	55,739	17,015
Interest expense	(464)	(953)
Other income and expense (Note 15)	(11,825)	(177,383)

Net loss	(1,655,072)	(2,599,442)
Foreign currency translation adjustment	1,067	25,405
Comprehensive loss	$ (1,654,005)	$ (2,574,037)
Net loss per share of common stock – basic and diluted (Note 6)	$ (0.03)	$ (0.07)
Weighted average number of shares of common stock outstanding – basic and diluted	57,806,060	39,896,829

See accompanying notes to consolidated financial statements

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Item 1. Consolidated Financial Statements (Continued)
Sona Mobile Holdings Corp. and Subsidiaries
Consolidated Statements of Cash Flows

	Three months ended March 31, 2007 (unaudited)	2006 (unaudited)
Cash provided by (used in):		
Operating activities		
Net loss	$ (1,655,072)	$ (2,599,442)
Adjustments for:		
Depreciation and amortization	12,285	7,837
Amortization of restricted stock-based compensation	17,976	148,000
Stock option expense	99,326	87,657
Gain on revaluation of common stock purchase warrants	—	146,655
Changes in non-cash working capital assets and liabilities:		
Accounts receivable	35,492	167,514
Prepaid expenses & deposits	10,750	(34,449)
Accounts payable	71,732	(126,371)
Accrued liabilities & payroll	(33,681)	42,773
Deferred revenue	61,778	63,986
Net cash used in operating activities	(1,379,414)	(2,095,840)
Investing activities		
Software development costs	(77,546)	—
Acquisition of property & equipment	(34,595)	—

Net cash used in investing activities	(112,141)	—
Financing activities		
Proceeds from the sale of common stock	—	1,664,400
Proceeds from exercise of stock options	—	2,668
Proceeds from the issuance of common stock purchase warrants	—	1,335,600
Net cash provided by financing activities	—	3,002,668
Effect of exchange rate changes on cash & cash equivalents	419	25,497
Change in cash & cash equivalents during the period	(1,491,136)	932,325
Cash & cash equivalents, beginning of period	5,682,162	1,286,912
Cash & cash equivalents, end of period	$ 4,191,026	2,219,237

There were no amounts paid in cash for taxes or interest in the first three months of 2007 or 2006.

See accompanying notes to consolidated financial statements.

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Note 1. Going Concern and Management's Plans

The accompanying consolidated financial statements of Sona Mobile Holdings Corp. (the ''Company'') have been prepared assuming that the Company will continue as a going concern. However, since its inception in November 2003, the Company has generated minimal revenue, has incurred substantial losses and has not generated any positive cash flow from operations. The Company has relied upon the sale of shares of equity securities to fund its operations. These conditions raise substantial doubt as to the Company's ability to continue as a going concern.

The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts or classification of liabilities that may result from the possible inability of the Company to continue as a going concern.

At March 31, 2007, the Company had total cash and cash equivalents of $4.2 million held in current and short-term deposit accounts. Management believes that based on the current level of spending, this cash will only be sufficient to fund the Company's operations until September 2007. Based on the current business plan, the Company will be obligated to seek additional financing before that time. There can be no assurance that the Company will be able to successfully implement its plans to raise additional capital or to increase revenue.The Company may not be able to obtain additional capital or generate new revenue opportunities on a timely basis, on favorable terms, or at all. If the Company cannot successfully implement its plans, the Company's liquidity, financial condition and business prospects will be materially and adversely affected and the Company may have to cease operations.

Note 2. Company Background and Description of Business

Sona Mobile, Inc. (''Sona Mobile'') was formed under the laws of the State of Washington in November 2003 for the purpose of acquiring Sona Innovations, Inc. (''Innovations''), which it did in December 2003. On April 19, 2005, Sona Mobile merged (the ''Merger'') with and into Perfect Data Acquisition Corporation, a Delaware corporation (''PAC'') and a wholly-owned subsidiary of PerfectData Corporation, also a Delaware corporation (''PerfectData''). Under the terms of that certain Agreement and Plan of Merger dated as of March 7, 2005, (i) PAC was the surviving company but changed its name to Sona Mobile, Inc.; (ii) the pre-merger shareholders of Sona Mobile received stock in PerfectData representing 80% of the voting power in PAC post-merger; (iii) all of Perfect Data's officers resigned and Sona Mobile's pre-merger officers were appointed as the new officers of PerfectData; and (iv) four of the five persons serving as directors of PerfectData resigned and the remaining director appointed the three pre-merger directors of Sona Mobile to the PerfectData Board of Directors. In November 2005, PerfectData changed its name to ''Sona Mobile Holdings Corp.''

At the time of the Merger, PerfectData was essentially a shell company that was not engaged in an active business. Upon completion of the Merger, PerfectData's only business was the historical business of Sona Mobile and the pre-merger shareholders of Sona Mobile controlled PerfectData. Accordingly, Sona Mobile was deemed the accounting acquirer and the Merger was accounted for as a reverse acquisition of a public shell and a recapitalization of Sona Mobile. No goodwill was recorded in connection with the Merger and the costs were accounted for as a reduction of additional paid-in-capital. The pre-merger financial statements of Sona Mobile are treated as the historical financial statements of the combined companies and its historical stockholders' equity was adjusted to reflect the new capital structure.

The Company is a wireless software and service provider specializing in value-added services to data-intensive vertical and horizontal market segments. The Company develops and markets wireless data applications for mobile devices in the rapidly growing wireless data marketplace. The Company operates as one business segment focused on the development, sale and marketing of wireless application software.

The Company's value proposition is to unlock, integrate and seamlessly deliver all types of data to wireless devices, whether streaming financial markets data for the investment banking industry, complex databases and enterprise applications for supporting all areas of a corporate organization or

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live television and digital radio delivery to the growing consumer market via channel and content partners — anytime, anywhere. The Company markets its products and services principally to two large vertical markets.

- Gaming and entertainment. The Company proposes to (i) deliver casino games wirelessly in designated areas on casino properties; (ii) offer real-time, multiplayer games that accommodate an unlimited number of players; (iii) deliver games on a play-for-free or wagering basis (where permitted by law) on mobile telephone handsets over any carrier network; and (iv) deliver horse and sports wagering applications, where legal, for on-track and off-track wagering, including live streaming video of horse races and other sports events. The Company also proposes to deliver content via channel partners and content partners, including live streaming television, digital radio, specific theme downloads for mobile phones, media downloads and gaming applications.
- Financial services and enterprise software. The Company's products and services extend enterprise applications to the wireless arena, such as customer relationship management systems, sales force automation systems, information technology (IT) service desk and business continuity protocols, all of which the Company believes are delivered in compliance with the

current regulatory environment. One of the Company's primary focuses is to develop solutions for the data-intensive investment banking community and client-facing applications for the retail banking industry.

These products and services are deliverable globally across most of the major cellular networks and prominent wireless device operating systems. The Company's revenues consist primarily of project, licensing and support fees relating to our Sona Wireless Platform (''SWP'') and related end-user wireless application software products made available to enterprises and cellular operators.

Note 3. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The unaudited condensed consolidated financial statements herein include the accounts of the Company and its wholly-owned subsidiary, Sona Mobile, as well as Sona Mobile's wholly-owned subsidiaries, Innovations, a Canadian company and Sona Ltd. (''Sona Ltd.''), which is incorporated in the United Kingdom. All material inter-company accounts and transactions have been eliminated. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2006 and the notes thereto included in Form 10-KSB filed with the United States Securities and Exchange Commission on March 29, 2007. Results of consolidated operations for the interim periods are not necessarily indicative of the operating results to be attained for the entire fiscal year.

Recently issued accounting pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109 (FIN 48), which provides clarification related to the process associated with accounting for uncertain tax positions recognized in consolidated financial statements. FIN 48 prescribes a more-likely-than-not threshold for financial statement recognition and measurement of a tax position taken, or expected to be taken, in a tax return. FIN 48 also provides guidance related to, among other things, classification, accounting for interest and penalties associated with tax positions, and disclosure requirements. The Company adopted this provision on January 1, 2007. The Company's policy is to recognize interest

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and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of the date of adoption of FIN 48, there was no accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense or penalties recognized during the quarter ended March 31, 2007.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (''SFAS 157''), ''Fair Value Measurements.'' SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. SFAS No. 157 is effective for the first fiscal period beginning after November 15, 2007. The provisions of SFAS No. 157 are effective as of the beginning of the Company's 2008 fiscal year. The Company is currently evaluating the potential impact of adopting SFAS No. 157 on its financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. This standard will provide companies with the option to measure certain financial assets and financial liabilities at fair value. This standard requires companies to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. This standard also requires disclosure of additional information to identify the effects of a company's fair value election on its earnings. The provisions of SFAS No. 159 are effective as of the beginning of the Company's 2008 fiscal year. The Company is currently evaluating the potential impact of adopting SFAS No. 159 on its financial statements.

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Sona Mobile, Sona Mobile's wholly-owned subsidiary, Innovations and Sona Ltd. All inter-company accounts and transactions have been eliminated in consolidation.

(b) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and term deposits with original maturity dates of less than 90 days. Cash and cash equivalents are stated at cost, which approximates market value, and are concentrated in three major financial institutions.

(c) Foreign currency translation

The functional currency is the U.S. dollar as that is the currency in which the Company primarily generates revenue and expends cash. In accordance with the provisions of Statement of Financial Accounting Standards (''SFAS'') No. 52, ''Foreign Currency Translation,'' assets and liabilities denominated in a foreign currency have been translated at the period end rate of exchange. Revenue and expense items have been translated at the transaction date rate. For Innovations, which uses its local currency (Canadian dollar) as the functional currency, the resulting translation adjustments are included in other comprehensive income, as the company is a foreign self-sustaining operation. Other gains or losses resulting from foreign exchange transactions are reflected in earnings.

(d) Property and equipment

Property and equipment are stated at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of three to five years.

(e) Use of estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, at the date of the financial statements and

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the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

(f) Software rights

In April 2006, the Company completed the acquisition of certain software from Digital Wasabi, LLC, a Colorado limited liability company (''Digital Wasabi''). The software, which has not been fully developed, is intended to facilitate the playing of certain games of chance, such as bingo and poker, on mobile wireless communication devices. The in-process purchased software does not meet the criteria for capitalization as prescribed in SFAS 86 and as such was expensed in the quarter of acquisition.

(g) Income taxes

The Company accounts for income taxes in accordance with SFAS No. 109, ''Accounting for Income Taxes,'' which requires an asset and liability approach to financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed periodically for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. The income tax provision is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

(h) Revenue recognition

The Company derives revenue from license and service fees related to customization and implementation of the software being licensed. License fees are recognized in accordance with Statement of Position (''SOP'') 97-2, ''Software Revenue Recognition,'' as amended by SOP 98-4 and SOP 98-9, and in certain instances in accordance with SOP 81-1, ''Accounting for Performance of Construction-Type and Certain Production-Type Contracts.'' Service fees on contracts when future development is required are recorded on a percentage of completion or completed-contract basis depending on whether or not reliable estimates of the costs to complete the work can be obtained. License fees are recognized when the rights to use the software transfer, as long as there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection of the receivable is probable. When license fees are not fixed and determinable, they are recognized over the service period as they become determinable. The deferred revenues are amounts invoiced or received prior to completion of service.

(i) Research and software development costs

The Company incurs costs on activities that relate to research and the development of new software products. Research costs are expensed as they are incurred. Costs are reduced by tax credits where applicable. Software development costs to establish the technological feasibility of software applications developed by the Company are charged to expense as incurred. In accordance with SFAS 86, certain costs incurred subsequent to achieving technological feasibility are capitalized. Accordingly, a portion of the internal labor costs and external consulting costs associated with essential wireless software development and enhancement activities are capitalized. Costs associated with conceptual design and feasibility assessments as well as maintenance and routine changes are expensed as incurred. Capitalized costs are amortized based on current or future revenue for each product with an annual minimum equal to the straight-line basis of amortization over the estimated economic lives of the applications, not to exceed 5 years. Capitalized software development costs are periodically evaluated for impairment. Gross software development costs for the three-months ended March 31, 2007 and 2006 were $622,593 and $383,665, respectively. For the quarter ended March 31, 2007, $77,546 of the gross software development costs met the criteria of SFAS 86 for

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capitalization of software development costs and accordingly were capitalized as of that date with a corresponding reduction of software development expenses for the quarter. Capitalized software development costs were $77,546 and $0 as of March 31, 2007 and 2006, respectively.

(j) Stock-based compensation

As of January 1, 2006, the Company adopted the provisions of, and accounts for stock-based compensation in accordance with, the Financial Accounting Standards Board's (''FASB'') Statement of Financial Accounting Standards No. 123 – revised 2004 (''SFAS 123R''), ''Share-Based Payment'' which replaced Statement of Financial Accounting Standards No. 123 (''SFAS 123''), ''Accounting for Stock-Based Compensation'' and supersedes APB Opinion No. 25, ''Accounting for Stock Issued to Employees.'' Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. The Company elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding as of the effective date and are subsequently modified. Estimated compensation for grants that were outstanding as of the effective date will be recognized over the remaining service period using the compensation cost estimated for the SFAS 123 pro forma disclosures, as adjusted for estimated forfeitures.

During the first quarter of fiscal 2007 and during fiscal 2006 the Company issued stock options to directors, officers, and employees under the Amended and Restated Stock Option Plan of 2000 and the 2006 Incentive Plan as described in Note 11 to our consolidated financial statements. The fair value of these options was estimated at the date of grant using a Black-Scholes option-pricing model, using a range of risk-free interest rates of 4.24% – 5.17%, option terms ranging from 3 to 6.25 years, expected volatility of 65% and no dividend.

(k) Reclassifications

Certain reclassifications of previously reported amounts have been made to conform to the current year's presentation.

(l) Derivatives

The Company follows the provisions of SFAS No. 133 ''Accounting for Derivative Instruments and Hedging Activities'' (SFAS No. 133) along with related interpretations EITF No. 00-19 ''Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'' (EITF 00-19) and EITF No. 05-2 ''The Meaning of 'Conventional Convertible Debt Instrument' in Issue No. 00-19'' (EITF 05-2). SFAS No. 133 requires every derivative instrument (including certain derivative instruments embedded in other contracts) to be recorded in the balance sheet as either an asset or liability measured at its fair value, with changes in the derivative's fair value recognized currently in earnings unless specific hedge accounting criteria are met. The Company values these derivative securities under the fair value method at the end of each reporting period, and their value is marked to market with the gain or loss recognition recorded against earnings. The Company uses the Black-Scholes option-pricing model to determine fair value. Key assumptions of the Black-Scholes option-pricing model include applicable volatility rates, risk-free interest rates and the instrument's expected remaining life. These assumptions require significant management judgment. At March 31, 2007, there were no derivative instruments reported on the Company's balance sheet.

Note 4. Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable. Receivables arising from sales to customers are not collateralized and, as a result, management continually monitors the financial condition of its customers to reduce the risk of loss. Customer account balances with invoices dated over 90 days are considered delinquent. The Company maintains reserves for potential credit losses based upon its loss

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history, its aging analysis and specific account review. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. Such losses have been within management's expectations. The Company has some exposure to a concentration of credit risk as it relates to specific industry segments, as historically its customers have been primarily concentrated in the financial services industry. Since revenues are derived in large part from single projects, the Company bears some credit risk due to a high concentration of revenues from individual customers. During the first quarter of fiscal 2007, 88% of total revenues were generated from two customers that individually represented over 10% of total revenue each. During the first quarter of fiscal 2006, 81% of total revenues were generated from four customers individually representing over 10% of total revenue each.

We had a balance of $25,769 in our Allowance for Doubtful Accounts provision as of March 31, 2007. This balance consists of provisions made in previous quarters. There were no bad debt write-offs against the provision in 2007. There was a total of $22,792 of bad debt write offs against the provision in 2006.

Note 5. Stockholders' Equity

In January 2006, the Company sold 2,307,693 shares of common stock and a warrant to purchase 1,200,000 shares of our common stock to Shuffle Master, Inc. (''Shuffle Master'') for $3.0 million. This warrant has an exercise price of $2.025 per share and expires on July 12, 2007. Using the Black-Scholes option model, the warrant was valued at $1,335,600 using a volatility of 65%, a term of 18 months, an expected dividend yield of 0% and a risk-free interest rate of 4.4%.

During fiscal 2006, a total of 43,334 stock options were exercised resulting in total proceeds to the Company of $69,334. A total of 457,778 shares of restricted stock were issued during fiscal 2006 to directors, officers and employees under the Company's compensation plans. Other stock transactions in 2006 included the issuance of 800,000 shares for the purchase of technology from Digital Wasabi. No cash proceeds were received in connection with these issuances and the stock was valued relative to the market price on the date of issuance.

On July 7, 2006 the Company closed a private placement to accredited investors whereby it sold 16,943,323 shares of common stock and warrants to purchase 8,471,657 shares of common stock for net proceeds of approximately $9.3 million after payment of commissions, as well as legal and accounting expenses. The warrants have an exercise price of $0.83 per share, subject to downward adjustment if the Company does not meet specified annual revenue targets, and are exercisable at any time during the period commencing July 7, 2006 and ending July 7, 2011. As a result of the Company not meeting the specified revenue targets for 2006, the exercise price of the warrants was adjusted downwards to $0.70 per share as of December 31, 2006. The warrants were valued at $3,114,595 using the Black-Scholes option-pricing model, assuming a risk-free interest rate of 5.10%, a five-year expected life, a volatility rate of 65%, and a dividend yield of 0%. The remainder of the net proceeds from the financing was credited to common stock and additional paid in capital.

The Company used $300,000 of the funds raised on July 7, 2006 to repurchase 650,000 shares of common stock from its former chief executive officer, John Bush. The shares have been classified as treasury shares and will be used when share issuances for restricted stock and stock option exercises occur. During fiscal 2006, 288,333 of the repurchased shares were used for some of the above mentioned issuances of restricted stock to employees and directors.

Series B Stock Warrants

In June 2005, the Company sold 3,848,700 shares accompanied by warrants to purchase 962,175 shares of its common stock to accredited investors for gross proceeds of $5.05 million (the ‘‘Series B Financing’’). As part of the financing transaction, the Company agreed to register and did register for resale the shares of common stock underlying the Series B Preferred Stock and the Series B Warrants. The registration statement became effective on April 24, 2006. During the second quarter of 2006, the Company issued an additional 8,553 Series B Warrants to the Series B investors because the registration statement was not declared effective by April 19, 2006, as required by the Series B financing agreements.

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From the date of issuance through the quarter ended March 31, 2006, the warrants issued in the Series B Financing were classed as a liability in accordance with the provisions of SFAS 133, SFAS 150 and EITF 00-19. These standards require the Company to re-measure the value at the end of each reporting period with the resulting increase or decrease to the liability reported as a component of the Consolidated Statements of Operation and Comprehensive Loss. As a result of the increase in the value of the warrants from the time of issuance to the quarter ended March 31, 2006, a cumulative revaluation expense of $246,675 was included in Other Income and Expense. This included $146,655 for the first quarter of 2006 and $100,020 which was booked in 2005.

Upon the effectiveness of the resale registration statement on April 24, 2006, the Company determined that the provisions of EITF 00-19 allowed the Company to reclassify these financial instruments as equity. In accordance with EITF 00-19, the warrants were valued as of the date of the effectiveness of the registration statement and were reclassified as equity. The gain of $614,981 as a result of the April 24, 2006 valuation was charged to other income in the second quarter of 2006.

The warrants issued in the Series B Financing had an exercise price of $1.968 per share. The issuance of 2,307,693 shares to Shuffle Master in January 2006 at a share price of $1.30 per share and the issuance of 16,943,332 shares at $0.60 in the July 2006 private placement financing triggered an anti-dilution provision of the Series B Warrants. As such, the revised exercise price for the Series B Warrants was revised to $1.542 per share in the third quarter of 2006.

Note 6. Earnings per Share

Basic earnings (loss) per share are computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted earnings (loss) per share considers the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that shared in the earnings of the entity.

The calculation of diluted earnings (loss) per share did not include 5,942,500 shares of the Company’s common stock issuable upon the exercise of options nor did it include the 10,642,385 shares issuable upon exercise of the common stock warrants, as their inclusion in the calculation would be anti-dilutive.

Note 7. Commitments

Lease commitments. The Company leases office space in Toronto, Ontario and Boulder, Colorado. The Company was released from its lease obligation in New York, New York, which was to expire at the end of December 2007, at the end of September 2006. The Company is currently leasing space in New York, New York on a short-term basis under a lease which runs to May 2007, for its corporate headquarters and sales and support functions. The Company intends to renew its lease on substantially the same terms on a short-term basis when the current lease agreement expires. The Company has agreed with the existing landlord to move the Boulder office into new space commencing May 2007. This move terminated the existing lease and has been replaced by a new lease covering the new space. The lease of the new Boulder office commences on May 1, 2007 and will run through September 2010. Office lease expenses for the three-month periods ended March 31, 2007 and 2006 were approximately $101,000 and $158,000, respectively. In addition, the Company leases an apartment in Las Vegas, Nevada, which runs to February 28, 2008, as a cost effective way to house employees during frequent business visits to Las Vegas. The Company also leases office equipment. These leases have been classified as operating leases. Office equipment lease expenses for the three-month periods ended March 31, 2007 and 2006 were approximately $28,172 and $4,643, respectively. Future lease commitments by year are as follows (2007 amounts are for nine months):

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	Future Lease Commitments by Year (US$)				
	2007	2008	2009	2010	2011
Office Space Leases:					
United States	$ 121,290	$ 116,362	$ 125,926	$ 96,836	$ —
Canada	39,213	99,581	102,656	105,783	108,963
Total Office Space	160,503	215,943	228,582	202,619	108,963
Office Equipment	106,400	141,572	60,509	596	—
Total Lease Commitments	$				