

INTELLISYNC CORP  
Form 10-Q  
June 09, 2005

## **FORM 10-Q**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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

**For the quarterly period ended April 30, 2005**

**OR**

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

**For the transition period from            to**

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**Commission File Number 0-21709**

**INTELLISYNC CORPORATION**

(Exact name of Registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**77-0349154**  
(I.R.S. Employer  
Identification Number)

**2550 North First Street, San Jose, California 95131**

(Address of principal executive office and zip code)

**(408) 321-7650**

(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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of June 6, 2005: 66,633,155

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**INTELLISYNC CORPORATION**

**10-Q REPORT**

**INDEX**

**PART I - FINANCIAL INFORMATION**

<u>Item 1.</u>	<u>Unaudited Condensed Consolidated Financial Statements</u>	1
	<u>Condensed Consolidated Balance Sheets as of April 30, 2005 and July 31, 2004</u>	1
	<u>Condensed Consolidated Statements of Operations for the three and nine months ended April 30, 2005 and 2004</u>	2
	<u>Condensed Consolidated Statements of Cash Flows for the nine months ended April 30, 2005 and 2004</u>	3
	<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	4
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	58
<u>Item 4.</u>	<u>Controls and Procedures</u>	59

**PART II - OTHER INFORMATION**

<u>Item 1.</u>	<u>Legal Proceedings</u>	60
<u>Item 2.</u>	<u>Changes in Securities and Use of Proceeds</u>	60
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	60
<u>Item 4.</u>	<u>Submission of Matters to a Vote of Security Holders</u>	60
<u>Item 5.</u>	<u>Other Information</u>	60
<u>Item 6.</u>	<u>Exhibits</u>	60

<b><u>SIGNATURE</u></b>		61
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<b><u>EXHIBIT INDEX</u></b>		62
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## INTELLISYNC CORPORATION

## PART I - FINANCIAL INFORMATION

## Item 1. Unaudited Condensed Consolidated Financial Statements

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

(Unaudited)

	April 30, 2005	July 31, 2004
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 23,910	\$ 12,991
Short-term investments	23,235	40,657
Accounts receivable, net of allowance for doubtful accounts of \$560 and \$470	11,682	10,380
Inventories	33	69
Other current assets	2,435	2,485
<b>Total current assets</b>	<b>61,295</b>	<b>66,582</b>
Property and equipment, net	2,357	1,540
Goodwill	67,536	65,288
Other intangible assets, net	25,876	29,828
Restricted cash	3,979	4,032
Other assets	2,810	3,084
<b>Total assets</b>	<b>\$ 163,853</b>	<b>\$ 170,354</b>
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 2,337	\$ 1,562
Accrued liabilities	6,675	7,482
Current portion of obligations under capital lease	149	51
Deferred revenue	6,093	5,794
<b>Total current liabilities</b>	<b>15,254</b>	<b>14,889</b>
Obligations under capital lease	250	144
Convertible senior notes	57,884	58,443
Other liabilities	2,674	2,487
<b>Total liabilities</b>	<b>76,062</b>	<b>75,963</b>
Commitments and contingencies (Note 8)		

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Stockholders' equity:			
Preferred stock, \$0.001 par value; 2,000 shares authorized; none issued and outstanding at April 30, 2005 and July 31, 2004			
Common stock, \$0.001 par value; 160,000 shares authorized; 66,630 and 65,592 shares issued and outstanding at April 30, 2005 and July 31, 2004	67		66
Additional paid-in capital	227,026		225,832
Accumulated deficit	(139,957)		(131,116)
Accumulated other comprehensive income (loss)	655		(391)
Total stockholders' equity	87,791		94,391
Total liabilities and stockholders' equity	\$	163,853	\$ 170,354

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The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.



## INTELLISYNC CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2005	2004	2005	2004
Revenue				
License	\$ 9,643	\$ 7,512	\$ 28,662	\$ 20,336
Services	5,594	3,495	15,133	8,690
Total revenue	15,237	11,007	43,795	29,026
Cost and operating expenses:				
Cost of revenue (includes non-cash stock compensation of \$2, \$(94), \$(19) and \$8, respectively)	2,537	2,237	7,397	5,667
Amortization of developed and core technology	1,187	990	3,515	1,543
Research and development (includes non-cash stock compensation of \$5, \$(30), \$1 and \$37, respectively)	3,810	3,495	10,819	8,098
Sales and marketing (includes non-cash stock compensation of \$43, \$(206), \$4 and \$11, respectively)	8,209	4,612	20,055	11,463
General and administrative (includes non-cash stock compensation of \$20, \$(205), \$5 and \$673, respectively)	2,221	1,582	6,383	5,894
Amortization of other intangibles	1,074	679	3,176	1,003
In-process research and development		775		3,667
Other charges		253		929
Total cost and operating expenses	19,038	14,623	51,345	38,264
Operating loss	(3,801)	(3,616)	(7,550)	(9,238)
Other income (expense):				
Interest income	304	171	813	410
Interest expense	(389)	(99)	(907)	(99)
Other, net	(158)	(99)	(625)	(86)
Litigation settlement gain, net		1,576		1,576
Total other income (expense)	(243)	1,549	(719)	1,801
Loss before income taxes	(4,044)	(2,067)	(8,269)	(7,437)
Provision for income taxes	(317)	(117)	(572)	(260)
Net loss	\$ (4,361)	\$ (2,184)	\$ (8,841)	\$ (7,697)
Basic and diluted net loss per common share	\$ (0.07)	\$ (0.03)	\$ (0.14)	\$ (0.14)
Shares used in computing basic and diluted net loss per common share	66,523	63,859	65,451	55,575

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.





## INTELLISYNC CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended April 30,	
	2005	2004
<b>Cash flows from operating activities:</b>		
Net loss	\$ (8,841)	\$ (7,697)
Adjustments to reconcile net loss to net cash used in operating activities:		
In-process research and development		3,667
Allowance for doubtful accounts	90	193
Depreciation	898	753
Amortization	6,691	2,546
Amortization of debt issuance costs	495	92
Non-cash stock compensation (recovery)	(9)	729
Changes in operating assets and liabilities, net of business acquisitions:		
Accounts receivable	(1,081)	(1,628)
Inventories	36	(87)
Other current assets	276	(709)
Other assets	75	(294)
Accounts payable	775	(1,940)
Accrued liabilities	(1,553)	(3,430)
Deferred revenue	299	49
Net cash used in operating activities	(1,849)	(7,756)
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	(1,412)	(441)
Purchase of short term investments	(5,902)	(30,565)
Proceeds from the sales of short-term investments	17,347	5,100
Proceeds from the maturities of short-term investments	5,950	5,650
Increase in restricted cash	(61)	(3,709)
Acquisitions, net of cash acquired	(4,095)	(17,951)
Net cash provided by (used in) investing activities	11,827	(41,916)
<b>Cash flows from financing activities:</b>		
Proceeds from long-term debt		60,000
Debt issuance cost	(229)	(2,878)
Principal payments on borrowings		(1,764)
Principal payments on capital lease	(92)	(18)
Note repayments from stockholders		310
Proceeds upon exercise of stock options	585	1,549
Proceeds from ESPP shares issued	619	337
Net cash provided by financing activities	883	57,536
Effect of exchange rate changes on cash and cash equivalents	58	18
Net increase in cash and cash equivalents	10,919	7,882
Cash and cash equivalents at beginning of period	12,991	7,842

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Cash and cash equivalents at end of period	\$	23,910	\$	15,724
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The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

**INTELLISYNC CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1 The Company and a Summary of its Significant Accounting Policies**

*The Company*

Intellisync Corporation, Intellisync or the Company, develops, markets and supports desktop, enterprise and mobile carrier-class push-email, synchronization and systems management software that enables consumers, business professionals and information technology professionals to extend the capabilities of enterprise groupware and vertical applications, handheld organizers/computers, Web-enabled mobile phones, pagers and other wireless or wireline personal communications platforms. The Company's Identity Systems (formerly Search Software America) subsidiaries develop, market and support global solutions that enhance an organization's ability to search, find, match (synchronize), screen and group identity data within their computer systems and network databases.

*Liquidity and Capital Resources*

The Company has incurred losses and negative cash flows since inception. The Company incurred a net loss of approximately \$8,841,000 and negative cash flows from operations of approximately \$1,849,000 for the nine months ended April 30, 2005. The Company's cash balances may decline further, although the Company believes that its existing cash resources, combined with revenue from continuing operations, will be adequate to fund its operations, including potential acquisitions, for at least the next 12 months. Failure to generate sufficient revenue or control spending could adversely affect the Company's ability to achieve its business objectives.

*Basis of Presentation and Consolidation*

The accompanying condensed consolidated financial statements of Intellisync as of April 30, 2005 and for the three and nine months ended April 30, 2005 are unaudited and reflect all normal recurring adjustments which are, in the opinion of management, necessary for their fair statement. These condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2004. The condensed consolidated balance sheet as of July 31, 2004 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The results of operations for the interim period ended April 30, 2005 are not necessarily indicative of results to be expected for the full year.

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

*Use of Estimates and Assumptions*

The preparation of the condensed consolidated financial statements in conformity with generally accepted accounting principles requires the Company 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 condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. On an on-going basis, the Company evaluates its estimates, including those related to provision for doubtful accounts, channel inventory and product returns, valuation of intangibles, investments and other long-lived assets, restructuring accruals, license and service revenue recognition, taxes and contingencies. The Company bases its estimates on various factors and information which may include, but are not limited to, history and prior experience, experience of other enterprises in the same industry, new related events, current economic conditions and information from third party professionals that are believed to be reasonable under the circumstances, the results of which form the basis for

taking judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

#### *Revenue Recognition*

Revenue is derived from software licenses and related services, which include implementation and integration of software solutions, post contract support, training, hosting and consulting.

Transactions involving the sale of software products are accounted for under the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Modification of 97-2, Software Revenue Recognition with Respect to Certain Transactions*. For contracts with multiple elements, and for which vendor-specific objective evidence of fair value for the undelivered elements exists, revenue is recognized for the delivered elements based upon the residual contract value as prescribed by SOP No. 98-9. The Company has accumulated relevant information from contracts to use in determining the availability of vendor-specific objective evidence and believes that such information complies with the criteria established in SOP No. 97-2 as follows:

Customers are required to pay separately for maintenance. Optional stated future renewal rates are included as a term of the contracts. The Company uses the renewal rate as vendor-specific objective evidence of fair value for maintenance.

The Company charges standard hourly rates for consulting services, when such services are sold separately, based upon the nature of the services and experience of the professionals performing the services.

For training, the Company charges standard rates for each course based upon the duration of the course, and such courses are separately priced in contracts. The Company has a history of selling such courses separately.

Revenue from license fees is recognized when persuasive evidence of an arrangement exists, delivery of the product has occurred, no significant Company obligations with regard to implementation or integration exist, the fee is fixed or determinable and collectibility is probable. Arrangements for which the fees are not deemed probable for collection are recognized upon cash collection. Payments from customers received in advance of revenue recognition are recorded as deferred revenue.

Service revenue primarily comprises revenue from consulting fees, maintenance contracts, training and hosting fees. Service revenue from consulting, hosting and training is recognized as the service is performed. Maintenance contracts include the right to unspecified upgrades and ongoing support. Maintenance revenue is deferred and recognized ratably as services are provided over the maintenance period.

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License and service revenue on contracts involving significant implementation, customization or services, that are essential to the functionality of the software is recognized over the period of each engagement, primarily using the percentage-of-completion method. Labor hours incurred is generally used as the measure of progress towards completion as prescribed by SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Product-Type Contracts*. Revenue for these arrangements is classified as license revenue and service revenue based upon estimates of fair value for each element, and the revenue is recognized based on the percentage-of-completion ratio for the arrangement. A provision for estimated losses on engagements is made in the period in which the loss becomes probable and can be reasonably estimated. The Company considers a project completed when all contractual obligations have been met (generally the go live date).

The Company currently licenses its products directly to individuals, small businesses and corporations, to original equipment manufacturers, or OEMs, and to distributors and value-added resellers in North America, Europe, the Asia-Pacific region, South America and Africa. Revenue from products distributed indirectly through major distributors and resellers is recognized on a sell through basis. Agreements with the Company's major distributors and resellers contain specific product return privileges for stock rotation and obsolete products that are generally limited to contractual amounts. Reserves for estimated future returns are provided for upon revenue recognition.

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Product returns are recorded as a reduction of revenue. Accordingly, the Company has established a product returns reserve composed of 100% of product inventories held at the Company's distribution partners, as well as an estimated amount for returns from customers of the distributors and other resellers as a result of stock rotation and obsolete products. Such reserves are based on:

historical product returns and inventory levels on a product by product basis;

current inventory levels and sell through data on a product by product basis as reported by the Company's major distributors worldwide;

demand forecast by product in each of the principal geographic markets, which is impacted by the Company's product release schedule, seasonal trends and analyses developed by the Company's internal sales and marketing group; and

general economic conditions.

The Company licenses rights to use its technology portfolio, whereby licensees, particularly OEMs, typically pay a non-refundable license fee in one or more installments and on-going royalties based on their sales of products incorporating the Company's technology. Revenue from OEMs under minimum guaranteed royalty arrangements, which are not subject to future obligations, is recognized when such royalties are earned and become payable. Royalty revenue is recognized as earned when reasonable estimates of such amounts can be made. Royalty revenue that is subject to future obligations is recognized when such obligations are fulfilled. Royalty revenue that exceeds minimum guarantees is recognized in the period earned.

### *Stock-Based Compensation*

The Company accounts for non-cash stock-based employee compensation using the intrinsic method in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees and Related Interpretations*, and complies with the disclosure provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation* and SFAS No. 148, *Accounting for Stock-Based Compensation, Transition and Disclosures*. Stock and other equity instruments issued to non-employees is accounted for in accordance with SFAS No. 123 and Emerging Issues Task Force Issue (EITF) No. 96-18, *Accounting for Equity Instruments Issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services* and valued using the Black-Scholes model. Expense associated with stock-based compensation is being amortized on an accelerated basis over the vesting period of the individual award consistent with the method described in Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 28.

If compensation cost for the Company's stock plans had been determined consistent with SFAS No. 123 *Accounting for Stock-Based Compensation*, the Company's net loss and loss per common share would have been adjusted to the pro-forma amounts indicated below (in thousands, except per common share data):

	Three Months Ended		Nine Months Ended	
	April 30,		April 30,	
	2005	2004	2005	2004
Net loss as reported	\$ (4,361)	\$ (2,184)	\$ (8,841)	\$ (7,697)



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Add: Stock-based employee compensation expense (recovery) included in reported net loss		70		(535)		(9)		729
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards		1,782		1,127		4,280		2,926
Pro forma net loss	\$	(6,073)	\$	(3,846)	\$	(13,130)	\$	(9,894)
Basic and diluted net loss per common share as reported	\$	(0.07)	\$	(0.03)	\$	(0.14)	\$	(0.14)
Basic and diluted pro forma net loss per common share	\$	(0.09)	\$	(0.06)	\$	(0.20)	\$	(0.18)

Because the Black-Scholes option valuation model was developed for traded options and requires the input of subjective assumptions and the number of future shares to be issued or cancelled is not known, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

#### *Derivative Instruments*

The Company applies SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, which establishes accounting and reporting standards for derivative instruments and for hedging activities. SFAS No. 133 requires that an entity recognize derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. The Company designates its derivatives based upon criteria established by SFAS No. 133. For a derivative designated as a fair value hedge, the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributed to the risk being hedged. For a derivative designated as a cash flow hedge, the effective portion of the derivative's gain or loss is initially reported as a component of accumulated other comprehensive income and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately. Refer to Note 7 for details on the Company's only derivative instrument.

#### **Note 2 Recently Issued Accounting Pronouncements**

##### *Other-Than-Temporary Impairment*

In March 2004, the EITF reached consensus on Issue 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. EITF No. 03-01 includes new guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. The disclosure requirements are effective for fiscal years ending after June 15, 2004. The Company has adopted the disclosure requirements in fiscal 2004 accordingly and incorporated such disclosures in note 3 to consolidated financial statements included in its Annual Report on Form 10-K for the fiscal year ended July 31, 2004. The accounting guidance of EITF No. 03-01 is applicable for reporting periods after June 15, 2004. However, the effective date of such guidance has been delayed until the FASB issues a Staff Interpretation on this matter. The delay does not have a specified date. Until an effective date is determined, existing guidance continues to apply in determining if an impairment is other than temporary. The Company will evaluate the impact of EITF No. 03-01 once final guidance is issued.

##### *Contingently Convertible Debt on Diluted Earnings per Share*

In October 2004, the EITF reached a consensus on EITF No. 04-8 *The Effect of Contingently Convertible Debt on Diluted Earnings per Share*, that the dilutive effect of contingent convertible debt instruments (CoCos) must be included in diluted earnings per share regardless of whether the triggering contingency has been satisfied, if dilutive. Adoption of EITF No. 04-08 would be on a retroactive basis and would require restatement of prior period diluted earnings per share, subject to certain transition provisions. It is effective for all periods ending after December 15, 2004. Due to the losses the Company incurred for the three and nine months ended April 30, 2005, diluted net loss per share does not differ from basic net loss per share, since potential shares of common stock issuable upon the conversion of the convertible debt are anti-dilutive for all periods presented. EITF No. 04-8 could have a future impact on the Company's results of operations in the event that the potential shares of common stock issuable upon conversion of the convertible debt were included in the diluted earnings per share calculation.

*Inventory Costs*

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs - an amendment of ARB No. 43, Chapter 4*, that requires that items such as idle facility expense, excessive spoilage, double freight and handling costs be recognized as current period charges. In addition, it requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective in

fiscal years beginning after June 2005. The Company expects SFAS No. 151 to have no material effect on its consolidated financial statements.

#### *Discontinued Operations*

In November 2004, the EITF reached a consensus on No. 03-13, *Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations*. EITF No. 03-13 relates to components of an enterprise that are either disposed of or classified as held for sale in fiscal periods beginning after December 15, 2004. EITF No. 03-13 allows significant events or circumstances that occur after the balance sheet date but before the issuance of financial statements to be taken into consideration in the evaluation of whether a component should be presented as discontinued or continuing operations, and modifies assessment period guidance to allow for an assessment period greater than one year. The consensus in EITF No. 03-13 was effective for the Company beginning February 1, 2005. The impact to the Company of adopting EITF Issue No. 03-13 will depend on the nature and extent of any long-lived assets disposed of or held for sale after the effective date, but the Company does not currently expect EITF No. 03-13 to have a material impact on its consolidated results of operations, cash flows or financial position.

#### *Exchanges of Nonmonetary Assets*

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions*. SFAS No. 153 states that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, SFAS No. 153 eliminates the narrow exception for nonmonetary exchanges of similar productive assets and replaces it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of SFAS No. 153 shall be applied prospectively. The Company does not believe the adoption of SFAS No. 153 will have a significant impact on its consolidated results of operations or financial position.

#### *Share-Based Payment*

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment, an amendment of FASB Statements No. 123 and 95*. The principal effect of SFAS No. 123R will be to require the inclusion in the Company's earnings of a compensation expense for stock option grants and employee stock plan purchases that previously was only reported as a disclosure in a note to the Company's consolidated financial statements. The Company is required to adopt the provisions of SFAS No. 123R as of August 1, 2005 but may elect to early adopt the provision effective the first day of any quarter prior to that date. The Company is presently studying SFAS No. 123R and has not yet determined which method it will select for its adoption of SFAS No. 123R, which the Company expects to have a potential material impact on its annual earnings.

On March 29, 2005, the SEC staff issued Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment* to express the views of the staff regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and to provide the staff's views regarding the valuation of share-based payment arrangements for public companies. The Company is currently in the process of implementing SFAS No. 123R, effective as of August 1, 2005, and will take into consideration the additional guidance provided by SAB No. 107 in connection with the implementation of SFAS No. 123R.

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### *Tax Deduction Provided For In the American Jobs Creation Act of 2004*

In December 2004, the FASB issued FASB Staff Position No. 109-1, *Application of SFAS No. 109 to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*. This staff position provides guidance for the accounting of a deduction provided to U. S. manufacturing companies and is effective immediately. The Company believes the adoption of this position will not currently have a material effect

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on its financial position or results of operations due to the Company's net operating losses. However, there is no assurance that there will not be a material impact in the future.

### *Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*

In December 2004, the FASB issued FASB Staff Position No. 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*. The American Jobs Creation Act introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. This position provides accounting and disclosure guidance for the repatriation provision. The Company does not believe the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 nor the FASB Staff Position will have a material impact on its financial condition or results of operations.

### *Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143*

In March 2005, the FASB issued FIN No. 47, *Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143, Accounting for Asset Retirement Obligations*. FIN No. 47 clarifies when an entity would be required to recognize a liability for the fair value of an asset retirement obligation that is conditional on a future event if the liability's fair value can be reasonably estimated. Uncertainty surrounding the timing and method of settlement that may be conditional on events occurring in the future would be factored into the measurement of the liability rather than the recognition of the liability. FIN No. 47 is effective for fiscal years ending after December 15, 2005. The Company is currently assessing the impact that the interpretation may have on its consolidated financial position and results of operations.

### **Note 3 Balance Sheets Components**

Inventories consist of the following (in thousands):

	April 30, 2005		July 31, 2004
Raw materials	\$	28	\$ 54
Finished goods and work-in-process		5	15
Inventories	\$	33	\$ 69

### **Note 4 Acquisitions**

The Company acquired Tourmaline Networks, Inc. in March 2005. In addition, the following acquisitions were closed in fiscal 2004: SoftVision SRL's workforce through a transfer agreement; SPL Worldgroup Software, Inc., SPL Worldgroup Ltd. and Search Software America Pty. Ltd., or collectively SSA and now called Identity Systems; Synchrologic, Inc.; and Spontaneous Technology, Inc. The Tourmaline, Identity Systems, Synchrologic and Spontaneous Technology transactions were accounted for as a business combination under SFAS No. 141, *Business*

*Combinations.* The SoftVision workforce transfer was accounted for as an asset purchase.

*Tourmaline Networks, Inc.*

On March 1, 2005, the Company completed its acquisition of all of the issued and outstanding stock of Tourmaline Networks, Inc., a privately held developer and marketer of mobile email based on QUALCOMM's BREW® solution headquartered in San Diego, California. Under the terms of an Agreement and Plan of Merger, dated as of February 9, 2005, the outstanding shares of Tourmaline common stock were converted into the right to receive (i) an aggregate of approximately \$4,118,000 in aggregate initial cash consideration and (ii) an aggregate of up to \$2,881,918 in cash earnout consideration (based on future revenue generated by the Company from the former Tourmaline client base), subject to the deposit of a certain portion of the initial cash consideration and earnout

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consideration in escrow to be available to compensate Intellisync pursuant to the indemnification obligations of the holders of Tourmaline common stock. The earnout consideration is due and payable shortly following the first anniversary of the acquisition.

The condensed consolidated financial statements include the results of operations of Tourmaline since the date of acquisition. Under the purchase method of accounting, the total purchase price was allocated to Tourmaline's net tangible and intangible assets based upon their estimated fair value as of the acquisition date. The purchase price of \$4,218,000 (including estimated acquisition costs of \$100,000) was assigned to the fair value of the assets acquired, including the following (in thousands):

Tangible assets acquired	\$	342
Deferred tax assets		795
Liabilities assumed		(275)
Deferred tax liability assumed		(795)
Developed and core technology		712
Customer base		1,285
Goodwill		2,154
	\$	4,218

In accordance with SFAS No. 109, *Accounting for Income Taxes*, deferred tax liabilities of approximately \$795,000 have been recorded for the tax effect of the amortizable intangible assets. Deferred tax assets of \$795,000 have also been recorded by the Company to account for the tax effect of the Company's net operating loss and credit carryforwards.

Tangible assets acquired, which includes \$23,000 of cash, and liabilities assumed were valued at their respective carrying amounts as the Company believes that these amounts approximated their current fair values at the acquisition date. The valuation of identifiable intangible assets acquired was based on management's estimates, currently available information and reasonable and supportable assumptions. This allocation was generally based on the fair value of these assets determined using the income approach.

An estimate of \$2,154,000 has been allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill will not be amortized but will be tested for impairment at least annually.

The purchase price allocation for Tourmaline is subject to further revision as more detailed analysis is completed and additional information on the fair values of Tourmaline's assets and liabilities becomes available. Any change in the fair value of the net assets of Tourmaline will change the amount of the purchase price allocable to goodwill. Final purchase accounting may therefore differ materially from the information presented above.

Of the total purchase price, \$1,997,000 was allocated to amortizable intangibles included in the above list. The amortizable intangible assets are being amortized using an accelerated method according to the expected cash flows to be received from the underlying assets over their respective estimated useful life of three to six years. Refer to Note 5.



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On June 14, 2004, the Company completed the transfer of 91 employees from SoftVision SRL, an offshore software development company with headquarters in Cluj-Napoca, Romania, pursuant to an Employee Transfer Agreement dated as of February 5, 2004. Under the terms of the agreement, the Company paid cash of approximately \$693,000 and assumed certain employee-related liabilities of approximately \$31,000. The SoftVision workforce acquisition was accounted for as an asset purchase. The condensed consolidated financial statements include the effect of additional employees the Company acquired from SoftVision since the date of acquisition.

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The full amount of the preliminary purchase price of \$724,000 was assigned to the fair value of the acquired workforce. The amortizable acquired workforce is being amortized using the straight-line method over its estimated useful life of two years. Refer to Note 5.

### *Identity Systems (formerly Search Software America)*

On March 16, 2004, the Company completed its acquisition of all of the issued and outstanding stock of SPL Worldgroup Software, Inc., SPL Worldgroup Ltd. and Search Software America Pty. Ltd., or collectively SSA, privately held divisions of SPL WorldGroup and headquartered in Sydney, Australia, pursuant to a Stock Purchase Agreement dated as of February 24, 2004. SSA, now called Identity Systems, with operations in the United States, United Kingdom, and Australia, is a developer of solutions that enhance the ability to find, match and group (synchronize) identity data within computer systems and network databases. Under the terms of the stock purchase agreement, the Company paid cash of \$22,129,000.

The condensed consolidated financial statements include the results of operations of Identity Systems since the date of acquisition. Under the purchase method of accounting, the total purchase price was allocated to Identity System's net tangible and intangible assets based upon their estimated fair value as of the acquisition date. The purchase price of \$22,179,000 (including acquisition costs of \$50,000) was assigned to the fair value of the assets acquired, including the following (in thousands):

Tangible assets acquired	\$	3,728
Liabilities assumed		(3,987)
Deferred tax liability assumed		(646)
In-process research and development		775
Developed and core technology		5,513
Customer base		8,777
Goodwill		8,019
	\$	22,179

In accordance with SFAS No. 109, *Accounting for Income Taxes*, deferred tax liabilities of approximately \$646,000 have been recorded for the tax effect of the amortizable intangible assets, which are not deductible for tax purposes.

The valuation of identifiable intangible assets acquired was based on management's estimates, currently available information and reasonable and supportable assumptions. This allocation was generally based on the fair value of these assets determined using the income approach.

Tangible assets acquired, which includes \$2,146,000 of cash, and liabilities assumed were valued at their respective carrying amounts as the Company believes that these amounts approximated their current fair values at the acquisition date. The valuation of identifiable intangible assets acquired was based on management's estimates, currently available information and reasonable and supportable assumptions. This allocation was generally based on the fair value of these assets determined using the income approach.

\$8,019,000 was allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill will not be amortized but will be tested for impairment at least annually.

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Of the total purchase price, \$14,290,000 was allocated to amortizable intangibles included in the above list. The amortizable intangible assets are being amortized using an accelerated method according to the expected cash flows to be received from the underlying assets over their respective estimated useful life of seven to ten years. Refer to Note 5.

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As of the acquisition date, technological feasibility of the in-process technology had not been established and the technology had no alternative future use. Accordingly, the Company expensed the in-process research and development at the date of the acquisition.

The amount of the purchase price allocated to in-process research and technology was based on established valuation techniques used in the high-technology software industry. The fair value assigned to the acquired in-process research and development was determined using the income approach, which discounts expected future cash flows to present value. The key assumptions used in the valuation include, among others, expected completion date of the in-process projects identified as of the acquisition date, estimated costs to complete the projects, revenue contributions and expense projections assuming the resulting product has entered the market, and discount rate based on the risks associated with the development life cycle of the in-process technology acquired. The discount rate used in the present value calculations are normally obtained from a weighted-average cost of capital analysis, adjusted upward to account for the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technology, and the uncertainty of technological advances that could potentially impact the estimates. The Company assumes the pricing model for the resulting product of the acquired in process research and technology to be standard within its industry. The Company, however, did not take into consideration any consequential amount of expense reductions from integrating the acquired in-process technology with other existing in-process or completed technology. Therefore, the valuation assumptions do not include significant anticipated cost savings.

The key assumptions underlying the valuation of acquired in-process research and development from Identity Systems are as follows (in thousands):

Project names: SSA-NAME3 Version 3.0 and IDS Version 3.0

Percent completed as of acquisition date: 10%

Estimated costs to complete technology at acquisition date: \$600,000

Risk-adjusted discount rate: 25%

First period expected revenue: June 2005

The development of the above technology remains highly dependent on the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for a new product, and significant competitive threats from several companies. The nature of the efforts to develop this technology into a commercially viable product consists primarily of planning, designing, experimenting, and testing activities necessary to determine that the technology can meet market expectations, including functionality and technical requirements. Failure to bring the product to market in a timely manner could result in a loss of market share or a lost opportunity to capitalize on emerging markets, and could have a material adverse impact on the Company's business and operating results.

Subsequent to the acquisition of Identity Systems, there have been no significant developments related to the current status of the acquired in-process research and development project that would result in material changes to the assumptions.

*Synchrologic, Inc.*

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On December 29, 2003, the Company completed its acquisition of all of the issued and outstanding stock of Synchronologic, Inc. headquartered in Atlanta, Georgia pursuant to an Agreement and Plan of Merger, dated as of September 14, 2003. Synchronologic's product line provides mobile access to enterprise applications, email and personal information management, or PIM, data, file content, intranet sites, and Web content, while giving IT groups the tools to manage mobile devices remotely.

In the merger, all outstanding shares of Synchronologic common stock and preferred stock were converted into the right to receive a total of 15,130,171 shares of the Company's common stock. In addition, all outstanding options to purchase Synchronologic common stock were converted into options to purchase a total of 1,018,952 shares of the Company's common stock. The total number of shares issued was determined by dividing \$60,000,000 by the

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average closing price of \$5.22 of the shares of the Company's common stock for the thirty consecutive trading days ending on the last complete trading day immediately preceding the closing date of the merger (which amount was subject to adjustment based on the transaction expenses incurred by Synchrologic in connection with the merger), provided that the number of shares did not exceed 19,800,000 or be fewer than 16,200,000 (in each case subject to adjustment based on the transaction expenses incurred by Synchrologic in connection with the merger). The shares were valued at approximately \$62,125,000 using the five-trading-day average price surrounding the date the acquisition was announced of \$4.11 per share, and the options were valued at approximately \$4,123,000 using the Black-Scholes option pricing model. The following assumptions were used to perform the calculations of the fair market value of stock options issued: fair value of Company's common stock of \$4.05, expected life of 3.9 years, risk-free interest rate of 3.4%, expected volatility of 132% and no expected dividend yield.

The condensed consolidated financial statements include the results of operations of Synchrologic since the date of acquisition. Under the purchase method of accounting, the total purchase price was allocated to Synchrologic's net tangible and intangible assets based upon the fair value as of the acquisition date. The purchase price of \$67,037,000 (comprising the value of the shares and options described above and the estimated acquisition costs of \$900,000 and net of a \$111,000 adjustment for writing-off a certain liability due to Synchrologic) was assigned to the fair value of the assets acquired, including the following (in thousands):

Tangible assets acquired	\$	4,105
Deferred tax assets		6,094
Liabilities assumed		(5,552)
Deferred tax liability assumed		(6,094)
In-process research and development		2,423
Developed and core technology		10,493
Patents		1,321
Customer base		3,487
Goodwill		50,760
	\$	67,037

In accordance with SFAS No. 109, *Accounting for Income Taxes*, deferred tax liabilities of approximately \$6,094,000 have been recorded for the tax effect of the amortizable intangible assets. Deferred tax assets of \$6,094,000 have also been recorded by the Company to account for the tax effect of Synchrologic's net operating loss and credit carryforwards.

The valuation of identifiable intangible assets acquired was based on management's estimates, currently available information and reasonable and supportable assumptions. This allocation was generally based on the fair value of these assets determined using the income approach.

Approximately \$50,760,000, as adjusted, was allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill associated with Synchrologic acquisition will not be amortized but will be tested for impairment at least annually.

Of the total purchase price, \$15,301,000 was allocated to amortizable intangibles included in the above list. The amortizable intangible assets are being amortized using the straight-line method over the estimated useful life of the respective assets of four years. Refer to Note 5.

As of the acquisition date, technological feasibility of the in-process technology had not been established and the technology had no alternative future use. Accordingly, the Company expensed the in-process research and development at the date of the acquisition.

The amount of the purchase price allocated to in-process research and technology was based on established valuation techniques used in the high-technology software industry. The fair value assigned to the acquired

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in-process research and development was determined using the income approach, which discounts expected future cash flows to present value. The key assumptions used in the valuation include, among others, expected completion date of the in-process projects identified as of the acquisition date, estimated costs to complete the projects, revenue contributions and expense projections assuming the resulting product has entered the market, and discount rate based on the risks associated with the development life cycle of the in-process technology acquired. The discount rate used in the present value calculations are normally obtained from a weighted-average cost of capital analysis, adjusted upward to account for the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technology, and the uncertainty of technological advances that could potentially impact the estimates. The Company assumed the pricing model for the resulting product of the acquired in process research and technology to be standard within its industry. The Company, however, did not take into consideration any consequential amount of expense reductions from integrating the acquired in-process technology with other existing in-process or completed technology. Therefore, the valuation assumptions do not include significant anticipated cost savings.

The key assumptions underlying the valuation of acquired in-process research and development from Synchrologic were as follows (in thousands):

Project names: Version upgrade of Data Sync, File Sync, E-mail Accelerator and Systems Management products

Percent completed as of acquisition date: 60%-70%

Estimated costs to complete technology at acquisition date: \$3,000,000

Risk-adjusted discount rate: 22%

First period expected revenue: calendar year 2004

The development of the above technology was highly dependent on the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for a new product, and significant competitive threats from several companies. The nature of the efforts to develop this technology into a commercially viable product consisted primarily of planning, designing, experimenting, and testing activities necessary to determine that the technology could meet market expectations, including functionality and technical requirements. Failure to bring the product to market in a timely manner could have resulted in a loss of market share or a lost opportunity to capitalize on emerging markets, and could have a material adverse impact on the Company's business and operating results.

Subsequent to the acquisition of Synchrologic, there have been no significant developments related to the current status of the acquired in-process research and development project that would result in material changes to the assumptions.

The liabilities assumed by the Company included Synchrologic's outstanding balance of approximately \$1,764,000 under a credit facility agreement with a bank. The Company fully paid the outstanding balance during fiscal 2004. The bank credit facility agreement was automatically terminated upon the Company's acquisition of Synchrologic.

*Spontaneous Technology, Inc.*



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On September 17, 2003, the Company consummated the acquisition of Spontaneous Technology, Inc. of Salt Lake City, Utah, a provider of enterprise secure Virtual Private Network, or sVPN™, software designed to extend existing corporate applications to most wireless devices. Under the terms of the agreement, the Company issued a total of 869,259 shares of Intellisync's common stock valued at approximately \$2,999,000 using the five-trading-day average price surrounding the date the acquisition was announced of \$3.45 per share, less registration costs. The number of shares were calculated using the average price of the Company's common stock for ten consecutive trading days ended three business days prior the date of acquisition. Later during fiscal 2004, Intellisync paid cash of approximately \$752,000 for the satisfaction of another pre-acquisition clause related to an acquired customer contract. There were also 224,417 additional shares released from escrow during fiscal 2005 that were issued upon satisfaction of a pre-acquisition clause. Additionally, Intellisync was required to pay Spontaneous Technology

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additional consideration of up to \$7,000,000 in shares of Intellisync's common stock. The additional consideration was contingent upon the amount of Intellisync's revenue associated with sales of its products including certain technology of Spontaneous Technology during the period ended September 30, 2004. The earnout period ended with Intellisync's aggregate revenue on products associated with Spontaneous Technology amounting to less than the given earnout threshold. Consequently, no additional consideration was paid to Spontaneous Technology.

The condensed consolidated financial statements include the results of operations of Spontaneous Technology since the date of acquisition. Under the purchase method of accounting, the total purchase price was allocated to Spontaneous Technology's net tangible and intangible assets based upon their fair value as of the acquisition date. The purchase price of \$4,071,000 (including acquisition costs of \$320,000 and the payment made for the resolution of the contingency of \$752,000) was assigned to the fair value of the assets acquired, including the following (in thousands):

Tangible assets acquired	\$	18
Liabilities assumed		(1,726)
In-process research and development		469
Developed and core technology		889
Patents		168
Customer base		499
Goodwill		3,754
	\$	4,071

Tangible assets acquired and liabilities assumed were valued at their respective carrying amounts as the Company believes that these amounts approximated their current fair values at the acquisition date. The valuation of identifiable intangible assets acquired was based on management's estimates, currently available information and reasonable and supportable assumptions. This allocation was generally based on the fair value of these assets determined using the income approach.

Approximately \$3,754,000, as adjusted, was allocated to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill will not be amortized but will be tested for impairment at least annually.

Of the total purchase price, \$1,556,000 was allocated to amortizable intangibles included in the above list. The amortizable intangible assets are being amortized using the straight-line method over the estimated useful life of the respective assets of four years. Refer to Note 5.

As of the acquisition date, technological feasibility of the in-process technology had not been established and the technology had no alternative future use. Accordingly, the Company expensed the in-process research and development at the date of the acquisition.

The amount of the purchase price allocated to in-process research and technology was based on established valuation techniques used in the high-technology software industry. The fair value assigned to the acquired in-process research and development was determined using the income approach, which discounts expected future cash flows to present value. The key assumptions used in the valuation include, among others, expected completion date of the in-process projects identified as of the acquisition date, estimated costs to complete the projects, revenue contributions and expense projections assuming the resulting product has entered the market, and discount rate based on the risks associated with the development life cycle of the in-process technology acquired. The discount rate used in the present value calculations are normally obtained from a weighted-average cost of capital analysis, adjusted upward to account for the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technology, and the uncertainty of

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technological advances that could potentially impact the estimates. The Company assumed the pricing model for the resulting product of the acquired in process research and technology to be standard within its industry. The Company, however, did not take into consideration any consequential amount of expense reductions from integrating the acquired in-process

technology with other existing in-process or completed technology. Therefore, the valuation assumptions do not include significant anticipated cost savings.

The key assumptions underlying the valuation of acquired in-process research and development from Spontaneous Technology were as follows (in thousands):

Project names: Version upgrade of Spontaneous Technology's secure Virtual Private Network (sVPN)

Percent completed as of acquisition date: 60%

Estimated costs to complete technology at acquisition date: \$125,000

Risk-adjusted discount rate: 22%

First period expected revenue: calendar year 2004

The development of the above technology was highly dependent on the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for a new product, and significant competitive threats from several companies. The nature of the efforts to develop this technology into a commercially viable product consisted primarily of planning, designing, experimenting, and testing activities necessary to determine that the technology could meet market expectations, including functionality and technical requirements. Failure to bring the product to market in a timely manner could have resulted in a loss of market share or a lost opportunity to capitalize on emerging markets, and could have had a material adverse impact on the Company's business and operating results.

Subsequent to the acquisition of Spontaneous Technology, there have been no significant developments related to the current status of the acquired in-process research and development project that would result in material changes to the assumptions.

***Unaudited Pro Forma Consolidated Combined Results***



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The following unaudited pro-forma consolidated financial information reflects the results of operations for the three and nine months ended April 30, 2005 and 2004, as if Tourmaline, Identity Systems, Synchrologic and Spontaneous Technology acquisitions had occurred on the beginning of each period presented and after giving effect to purchase accounting adjustments. The effect of SoftVision's transfer of workforce has been excluded from the pro forma financial information as amounts are considered immaterial to the Company.

These pro forma results have been prepared for comparative purposes only and do not purport to be indicative of what operating results would have been had the acquisitions in aggregate actually taken place on the beginning of each period presented. In addition, these results are not intended to be a projection of future results and do not reflect any synergies that might be achieved from the combined operation (in thousands, except per share data):

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2005	2004	2005	2004
Pro forma revenue	\$ 15,386	\$ 12,339	\$ 44,544	\$ 40,940
Pro forma net loss	\$ (4,407)	\$ (1,949)	\$ (5,377)	\$ (11,811)
Pro forma basic and diluted net loss per common share	\$ (0.07)	\$ (0.03)	\$ (0.08)	\$ (0.18)

The effect of the in-process research and development charges has been excluded in the above unaudited pro forma consolidated financial information as they represent non-recurring charges directly related to the acquisitions.

**Note 5 Goodwill, Developed and Core Technology and Other Intangible Assets**

The following table sets forth the changes in goodwill during the first two quarters of fiscal 2005 (in thousands):

	<b>Goodwill</b>
<b>Balance at July 31, 2004</b>	\$ 65,288
Acquired from Tourmaline	1,911
Foreign exchange effects on non-US dollar-denominated goodwill	94
<b>Balance at April 30, 2005</b>	\$ 67,293

Other intangible assets, net, consist of the following (in thousands, except weighted average useful life):

	Weighted Average Useful Life	Gross	April 30, 2005 Accumulated Amortization	Net	Gross	July 31, 2004 Accumulated Amortization	Net
Developed and core technology	4.3 years	\$ 22,536	\$ (8,964)	\$ 13,572	\$ 21,237	\$ (5,370)	\$ 15,867
Patents	4.0 years	1,680	(610)	1,070	1,680	(298)	1,382
Trademarks	2.5 years	250	(160)	90	250	(75)	175
Customer base	5.1 years	14,676	(3,822)	10,854	13,129	(1,472)	11,657
Covenant not-to-compete	2.0 years	105	(93)	12	105	(54)	51
Existing contracts	16.5 months	313	(306)	7	313	(296)	17
Acquired workforce	16 months	724	(453)	271	724	(45)	679
		\$ 40,284	\$ (14,408)	\$ 25,876	\$ 37,438	\$ (7,610)	\$ 29,828

Other intangible assets as of April 30, 2005 include a total of approximately \$1,997,000 amortizable identifiable intangibles obtained from the Company's acquisition of Tourmaline during the third quarter of fiscal 2005. The foreign exchange effects on non-US dollar-denominated intangibles and associated accumulated depreciation were \$849,000 and \$107,000, respectively, for the first three quarters of fiscal 2005.

The amortization of developed technology amounted to \$1,187,000 and \$3,515,000 for the three and nine months ended April 30, 2005, respectively, and \$990,000 and \$1,543,000 for the corresponding periods in fiscal 2004. The amortization of other intangible assets amounted to \$1,074,000 and \$3,176,000 for the three and nine months ended April 30, 2005, respectively, and \$679,000 and \$1,003,000 for the corresponding periods in fiscal 2004.

Based on acquisitions completed as of April 30, 2005, the estimated future amortization expense of other intangible assets is as follows (in thousands):

	<b>Developed and Core Technology</b>	<b>Other Intangibles</b>
Three months ending July 31, 2005	\$ 1,183	\$ 1,056
Fiscal year ending July 31,		

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2006	4,624	3,614
2007	4,381	3,076
2008	2,046	1,793
2009	685	955
2010	456	679
Thereafter	197	1,131
	\$ 13,572	\$ 12,304



**Note 6 Restructuring Accrual**



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The Company implemented a number of cost-reduction plans aimed at reducing costs that were not integral to its overall strategy, better aligning its expense levels with current revenue levels and ensuring conservative spending during periods of economic uncertainty. These initiatives included a reduction in workforce and facilities consolidation.

The following table sets forth the activities in the restructuring accrual account during the first three quarters of fiscal 2005 (in thousands):

		<b>Consolidation of Excess Facilities</b>
<b>Balance at July 31, 2004</b>	\$	1,080
Cash payments		(330)
<b>Balance at October 31, 2004</b>	\$	750
Cash payments		(218)
<b>Balance at January 31, 2005</b>	\$	532
Cash payments		(225)
<b>Balance at April 30, 2005</b>	\$	307

The remaining unpaid amount as of April 30, 2005 of \$307,000 related to the net lease expense due to the consolidation of excess facilities, will be paid over the respective lease terms through June 2006 using cash from operations.

The current and long-term portions of the restructuring accrual of \$267,000 and \$40,000 are classified as **Accrued Liabilities** and **Other Liabilities**, respectively, in the condensed consolidated balance sheet as of April 30, 2005.

The Company continually evaluates the balance of the restructuring reserve it records in prior periods based on the remaining estimated amounts to be paid. Differences, if any, between the estimated amounts accrued and the actual amounts paid will be reflected in operating expenses in future periods.

### **Note 7 Long-Term Debt**



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The following table sets forth the Company's long-term obligations, excluding capital lease obligations (in thousands):

	<b>April 30, 2005</b>	<b>July 31, 2004</b>
3% convertible senior notes, interest due semi-annually, principal due in March 2009	\$ 57,884	\$ 58,443
Interest rate swap fair value hedge adjustment on \$60 million of 3% convertible senior notes	2,116	1,557
	60,000	60,000
Less: current portion		
Long-term portion	\$ 60,000	\$ 60,000

### *3% Convertible Senior Notes*



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During the third quarter of fiscal 2004, the Company completed the offering of \$60,000,000 of convertible senior notes to qualified institutional buyers in reliance on Rule 144A under the Securities Act. The notes are senior

unsecured obligations of Intellisync and rank junior to any future secured debt, on a parity with all of the Company's other existing and future senior unsecured debt and prior to any existing or future subordinated debt. As of April 30, 2005, the Company had no other senior or subordinated debt, except for ordinary course trade payables. The Company may not redeem any of the notes prior to their maturity. Holders, however, may require the Company to repurchase the notes upon some types of change in control transactions. The notes will mature on March 1, 2009 unless earlier converted or redeemed. Neither the Company nor any of its subsidiaries are subject to any financial covenants under the indenture. In addition, neither the Company nor any of its subsidiaries are restricted under the indenture from paying dividends, incurring debt, or issuing or repurchasing its securities.

The notes are convertible into shares of common stock of the Company at any time prior to the close of business on the final maturity date of the notes, subject to prior redemption of the notes. The initial conversion rate is 250.0000 shares per each \$1,000 principal amount of notes which represents an initial conversion price of \$4.00 per share. The conversion rate is subject to adjustment for certain events, including the payment of dividends, and other events specified in the indenture.

The notes bear interest at a rate of 3% per annum. Interest on the notes will be paid on March 1 and on September 1 of each year.

#### *Interest Rate Swap*

During fiscal 2004, the Company entered into two interest rate swap agreements with a financial institution on a total notional amount of \$60,000,000, whereby the Company receives fixed-rate interest of 3% in exchange for variable interest payments. The interest rate swaps expire upon the maturity of the Company's \$60,000,000, 3% convertible senior notes in March 2009, and effectively convert fixed-rate notes into variable-rate borrowings. The interest rate is reset semi-annually and is equal to the 6-month LIBOR rate less a rate spread. The total variable interest rate, approximately 2.9% at April 30, 2005, resulted in interest expense savings relative to fixed rates of approximately \$486,000 for the first three quarters of fiscal 2005. Under the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, this arrangement has been designated and qualifies as an effective fair value hedge of interest rate risk related to the \$60,000,000 convertible senior notes. As the terms of the swaps match those of the underlying hedged debt, the changes in the fair value of these swaps are offset by corresponding changes in the carrying value of the hedged debt, and therefore do not impact the Company's net earnings. As of April 30, 2005, the fair value of the interest rate swaps was approximately \$2,116,000 and recorded in *Other Liabilities* with an equal adjustment recorded to the carrying value of the \$60,000,000 convertible senior notes.

Refer to Note 8 for the description of the collateral required on the interest rate swap.

#### **Note 8 Commitments and Contingencies**

##### *Leases*

During the first quarter of fiscal 2005, the Company entered into a capital lease agreement for computer peripherals, which expires in September 2007. In addition, during fiscal 2004, the Company entered into a capital lease agreement for a phone system, which expires in February 2008. Assets and future obligations related to the capital leases are included in the accompanying condensed consolidated balance sheet as of April 30, 2005 in property and equipment and in the respective liability accounts, respectively. Current and long-term portions of the



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capital leases amounted to \$149,000 and \$250,000, respectively, at April 30, 2005. Depreciation of assets held under the capital leases is included in depreciation and amortization expense.

The Company leases its facilities under operating leases that expire at various dates through December 2008. The total amount of rental payments due over the lease term is being charged to rent on the straight-line method over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent which is included in current liabilities in the accompanying balance sheets. Deferred rent was approximately \$301,000 at April 30, 2005. Total rent expense was approximately \$645,000 and \$1,851,000 for the

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three and nine months ended April 30, 2005, respectively, and approximately \$499,000 and \$1,152,000 for the corresponding periods in fiscal 2004.

Future minimum lease payments for all non-cancelable capital and operating lease agreements at April 30, 2005, were as follows (in thousands):

	Total		Three months ending July 31, 2005		Fiscal year ending July 31,									
					2006		2007		2008		2009			
Capital lease obligation(1)	\$	438	\$	44	\$	177	\$	177	\$	40	\$		\$	
Operating leases:														
Operating leases		5,225		924		2,786		766		544				205
Proceeds from subleases		(162)		(116)		(46)								
Net operating leases		5,063		808		2,740		766		544				205
Future minimum lease payments	\$	5,501	\$	852	\$	2,917	\$	943	\$	584	\$		\$	205

(1) Includes interest payments due.

*Guarantees*

The Company has three letters of credit that collateralize certain operating lease obligations and total approximately \$369,000 and \$397,000 at April 30, 2005 and July 31, 2004, respectively. The Company collateralizes these letters of credit with cash deposits made with three of its financial institutions and has classified the short-term and the long-term portions of approximately \$187,000 and \$182,000 at April 30, 2005, and \$101,000 and \$296,000 at July 31, 2004 as Other Current Assets and Restricted Cash, respectively, in the condensed consolidated balance sheets. The long-term portion expires through June 2006. The holders of the letters of credit are able to draw on each respective letter of credit in the event that the Company is found to be in default of its obligations under each of its operating leases.

Under the terms of the interest rate swap agreement into which the Company entered during fiscal 2004, the Company must provide collateral to match any unfavorable mark-to-market exposure (fair value) on the swap. The amount of collateral required totals a minimum of \$1,800,000 plus an amount equal to the unfavorable mark-to-market exposure on the swap. Generally, the required collateral will rise as interest rates rise. As of April 30, 2005, and July 31, 2004, the Company has posted approximately \$3,797,000 and \$3,736,000, respectively, of collateral under this swap agreement which is included in Restricted Cash in its condensed consolidated balance sheet.

In the event of early termination of the Company's service agreement with e deltacom, a division of ITC^DeltaCom, Inc. and a managed service provider, the Company may be required to pay e deltacom a penalty fee of up to approximately \$45,000.

*Litigation*

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In August 2004, a patent-infringement claim was filed against the Company by NCR Corporation in the U.S. District Court for the Southern District of Ohio. In the complaint, NCR alleged certain of the Company's products infringe three of its patents which allegedly cover technology for synchronizing databases between personal digital assistants and host computers. Based on a lengthy review, the Company believes that NCR's claims against it are without merit and the Company does not infringe on any of the asserted NCR patents. Separately, on September 9, 2004, the Company filed a complaint in the U.S. District Court for the Northern District of California against NCR requesting, among other things, that a declaratory judgment be entered finding that the Company does not infringe an NCR patent (6,473,765) that was asserted against one of the Company's licensees, Garmin Ltd. The Company has certain indemnification obligations to Garmin for claims related to intellectual property infringement. In response, NCR amended its suit against Garmin to withdraw its allegation of infringement of the 765 patent and stated that the Company has no liability to NCR for infringement of the 765 patent. NCR then moved to dismiss the California case on the basis that, because the Company could not be sued for infringement, the Court lacked jurisdiction to

adjudicate the Company's declaratory judgment action. Subsequently, the motion was granted and the California case was dismissed.

The Company is also involved in various litigation and claims arising in the normal course of business. In management's opinion, these matters are not expected to have a material impact on the Company's consolidated results of operations or financial condition.

**Note 9 Net Loss Per Common Share**

Basic net loss per common share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net loss per common share is computed by dividing net loss by the weighted average number of dilutive potential common shares that were outstanding during the period. Diluted weighted average shares reflect the dilutive effect, if any, of potential common shares based on the treasury stock method.

Basic and diluted net loss per common share were calculated as follows (in thousands, except per common share amounts):

	Three Months Ended April 30,				Nine Months Ended April 30,			
	2005		2004		2005		2004	
<i>Numerator:</i>								
Net loss	\$	(4,361)	\$	(2,184)	\$	(8,841)	\$	(7,697)
<i>Denominator:</i>								
Weighted average shares outstanding used to compute basic and diluted net loss per common share		66,523		63,859		65,451		55,575
Basic and diluted net loss per common share	\$	(0.07)	\$	(0.03)	\$	(0.14)	\$	(0.14)

All common shares that were held in escrow or that were subject to repurchase by the Company, totaling approximately zero and 1,389,000 as of April 30, 2005 and 2004, respectively, were excluded from basic and diluted net loss per common share calculations.

Potential common shares attributable to stock options, convertible senior notes, shares held in escrow and shares subject to repurchase by the Company of 27,701,165 and 25,784,894 were outstanding at April 30, 2005 and 2004, respectively. However, as a result of a net loss incurred by the Company in the three and nine months ended April 30, 2005 and 2004, none of the in-the-money potential common shares were included in the weighted average outstanding shares (using the treasury stock method) used to calculate net loss per common share because the effect would have been antidilutive.

**Note 10 Comprehensive Loss**

Accumulated other comprehensive loss consists of net unrealized gain/loss on available for sale investments and foreign currency translation adjustments. Total comprehensive loss for the three and nine months ended April 30, 2005 and 2004, respectively, is presented in the following table (in thousands):

	Three Months Ended April 30,				Nine Months Ended April 30,			
	2005		2004		2005		2004	
Net loss	\$	(4,361)	\$	(2,184)	\$	(8,841)	\$	(7,697)
Other comprehensive income (loss):								
Change in net unrealized income (loss) on investments		18		(47)		(7)		(81)
Realized loss on investments		(10)				(10)		
Change in currency translation adjustments		7		(32)		1,063		23
Total other comprehensive income (loss)		15		(79)		1,046		(58)
Total comprehensive loss	\$	(4,346)	\$	(2,263)	\$	(7,795)	\$	(7,755)

**Note 11 Business Segments**

Operating segments are identified as components of an enterprise about which separate, discrete financial information is available that is evaluated by the chief operating decision maker or decision-making group to make decisions about how to allocate resources and assess performance. The Company's chief operating decision maker is the chief executive officer. To date, the Company has reviewed its operations principally in a single segment.

The Company operates in a single industry segment encompassing the development, marketing and support of software and services that provide synchronization, wireless email, mobile application development, application/device management, real-time remote information access, secure VPN and identity searching/matching/screening capabilities. The Company's customer base consists primarily of corporate organizations, business development organizations, industry associations, mobile carriers, resellers, international system integrators, large OEMs in the personal computer, or PC, market and selected distributors, which primarily market to the retail channel, in North America, Europe, the Asia-Pacific region, South America, and Africa.

Revenue is attributed to regions based on the location of customers. Revenue information by geographic region is as follows (in thousands):

	Three Months Ended April 30,				Nine Months Ended April 30,			
	2005		2004		2005		2004	
United States	\$	10,287	\$	7,658	\$	29,704	\$	19,291
Japan		677		1,174		2,053		4,547
Other International		4,273		2,175		12,038		5,188
Total revenue	\$	15,237	\$	11,007	\$	43,795	\$	29,026



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Revenue information by product group is as follows (in thousands):

	Three Months Ended April 30,				Nine Months Ended April 30,			
	2005		2004		2005		2004	
	\$		\$		\$		\$	
Enterprise and retail products	\$	7,803	\$	6,576	\$	25,880	\$	14,172
Technology licensing components		7,434		4,431		17,915		14,854
Total revenue	\$	15,237	\$	11,007	\$	43,795	\$	29,026

The Company's enterprise and retail products include Intellisync® Handheld Edition, Intellisync Handheld Edition for Enterprise, Intellisync Phone Edition, Intellisync Mobile Suite® and Identity Search Server, as well as related support and maintenance. Technology licensing components include various licensed technology platforms, including Intellisync Mobile Suite, Identity Search Server, Intellisync goAnywhere, Intellisync Software Development Platform, Intellisync Server-to-Server, professional services, hosting services, non-recurring engineering services and related maintenance contract programs. Technology licensing components also include our Tourmaline products such as Soda-Pop Mail®, Email Executive, AOL® Mail and Eudora2go

One customer accounted for 11% of the Company's total revenue for the three months ended April 30, 2005. No customers accounted for more than 10% of the Company's total revenue for the nine months ended April 30, 2005 and for the three and nine months ended April 30, 2004.

Goodwill information by geographic region is as follows (in thousands):

	April 30, 2005		July 31, 2004	
United States	\$	60,691	\$	58,780
United Kingdom		4,922		4,828
Other International		1,680		1,680
Total goodwill	\$	67,293	\$	65,288

Other long-lived asset information by geographic region is as follows (in thousands):

	April 30, 2005		July 31, 2004	
United States	\$	27,362	\$	29,829
United Kingdom		1,776		2,030
Australia		5,624		6,209
Other International		503		416
Total long-lived assets	\$	35,265	\$	38,484

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

*The following information should be read in conjunction with the condensed consolidated financial statements and the notes thereto contained elsewhere in this Form 10-Q and in conjunction with the consolidated financial statements and management's discussion and analysis of financial condition and results of operations in our Form 10-K for the fiscal year ended July 31, 2004. This quarterly report on Form 10-Q, and in particular management's discussion and analysis of financial condition and results of operations, contains forward-looking statements regarding future events or our future performance that involve certain risks and uncertainties including those discussed in Factors That May Affect Future Operating Results below. In this Form 10-Q, the words anticipates, believes, expects, intends, future and similar expressions identify forward-looking statements. All statements that address operating performance, our stock price, expectations regarding the impact of litigation, events or developments that we expect or anticipate will occur in the future, including statements relating to planned product releases and composition of revenue, both in terms of segment and geographical source and our expectations as to the future revenue from our enterprise and retail products, are forward-looking statements. Such forward-looking statements are based on management's current views and assumptions regarding future events and operating performance, and speak only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statements whether as a result of new information, future events or otherwise. Actual events or our actual future results may differ materially from any forward-looking statements due to the risks and uncertainties outlined below.*

Management's discussion and analysis includes:

A business overview.

Estimates, assumptions and critical accounting policies.

A comparison of our results of operations in the three and nine months ended April 30, 2005 with the results in the corresponding periods in fiscal 2004.

Recently issued accounting pronouncements.

A discussion of our operating liquidity and capital resources.

A discussion of factors that may affect our future operating results.

### Business Overview



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We develop, market and support desktop, enterprise and mobile carrier-class push-email, synchronization and systems management software that enables consumers, business professionals and information technology professionals to extend the capabilities of enterprise groupware and vertical applications, handheld organizers/computers, Web-enabled mobile phones, pagers and other wireless or wireline personal communications platforms. Our Identity Systems (formerly Search Software America, or SSA) subsidiaries develop, market and support global solutions that enhance an organization's ability to search, find, match (synchronize), screen and group identity data within their computer systems and network databases.

We have organized our operations into a single operating segment encompassing the development, marketing and support of software and services that provide synchronization, wireless email, mobile application development, application/device management, real-time remote information access, secure VPN and identity searching/matching/screening capabilities.

We license our software products directly to corporations, mobile carriers, original equipment manufacturers, or OEMs, and business development organizations worldwide. In addition, we sell our retail products through several

distribution channels both in the United States and internationally, including major distributors, resellers, computer dealers, retailers and mail-order companies. Internationally, we are represented by distributors, resellers and retailers in North America, Europe, the Asia-Pacific region, South America and Africa.

***Recent Event***

On March 1, 2005, we completed our acquisition of all of the issued and outstanding stock of Tourmaline Networks, Inc., a privately held developer and marketer of mobile email based on QUALCOMM's BREW® solution headquartered in San Diego, California. Refer to the discussion under the caption *Liquidity and Capital Resources* set forth below for more information.

**Estimates, Assumptions and Critical Accounting Policies**



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Our financial statements and accompanying notes are prepared in accordance with generally accepted accounting principles in the United States of America. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, sales and expenses. These estimates and assumptions are affected by management's application of accounting policies. Our critical accounting policies include license and service revenue recognition, channel inventory and product returns, valuation of goodwill, other intangibles, investments and other long-lived assets, restructuring accruals, loss contingencies and provision for doubtful accounts which are discussed in more detail under the caption *Estimates, Assumptions and Critical Accounting Policies* in our Annual Report on Form 10-K for the fiscal year ended July 31, 2004.

## Results of Operations

The following table sets forth items included in the condensed consolidated statements of operations as a percentage of revenue for the periods indicated.

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2005	2004	2005	2004
Revenue				
License	63.3%	68.2%	65.4%	70.1%
Services	36.7	31.8	34.6	29.9
Total revenue	100.0%	100.0%	100.0%	100.0%
Cost and operating expenses:				
Cost of revenue	16.6	20.3	16.9	19.5
Amortization of developed and core technology	7.8	9.0	8.0	5.3
Research and development	25.0	31.8	24.7	27.9
Sales and marketing	53.9	41.9	45.8	39.5
General and administrative	14.6	14.4	14.6	20.3
Amortization of intangibles	7.0	6.2	7.2	3.5
In-process research and development		7.0		12.6
Other charges		2.3		3.2
Total cost and operating expenses	124.9	132.9	117.2	131.8
Operating loss	(24.9)	(32.9)	(17.2)	(31.8)
Other income (expense):				
Interest income	2.0	1.6	1.8	1.4
Interest expense	(2.6)	(0.9)	(2.1)	(0.3)
Other, net	(1.0)	(0.9)	(1.4)	(0.3)
Litigation settlement gain, net		14.3		5.4
Total other income (expense)	(1.6)	14.1	(1.7)	6.2
Loss before income taxes	(26.5)	(18.8)	(18.9)	(25.6)
Provision for income taxes	(2.1)	(1.1)	(1.3)	(0.9)
Net loss	(28.6)%	(19.9)%	(20.2)%	(26.5)%

### Revenue

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Total revenue	\$ 15,237	38.4%	\$ 11,007	\$ 43,795	50.9%	\$ 29,026

We derive revenue from two primary sources: software licenses and fees for services. The increase in revenue for the three and nine months ended April 30, 2005 was primarily due from revenue contributions of Synchrologic, Inc. and Identity Systems (formerly Search Software America, or SSA) product sales, both of which we acquired during fiscal 2004. The increase was also brought about by the continued

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fundamental shift in our customer base and revenue streams as we launched new wireless products and ramped up our wireless email solution with the global wireless market.

While the market for smartphones and other wireless mobile devices has grown recently, the market for wired or traditional personal digital assistants, or PDAs, has continued to face challenges. The overall decline in traditional PDA sales has had a direct impact on sales of our Intellisync products through the consumer and online channels,

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where sales of our synchronization software typically occur at the same time a PDA is purchased, or shortly thereafter. Due to this decline, our retail revenue, which consists of sales to distributors and direct sales to end-users, decreased during the first three quarters of fiscal 2005.

*License Revenue*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
License revenue	\$ 9,643	28.4%	\$ 7,512	\$ 28,662	40.9%	\$ 20,336
As percentage of total revenue	63.3%		68.2%	65.4%		70.1%

License revenue is earned from the sale and use of software products (including our technology licensing components) and royalty agreements with original equipment manufacturers, or OEMs. The increase in license revenue in absolute dollars for the three months ended April 30, 2005 as compared with that for the corresponding period of fiscal 2004 reflected an increase of \$1,395,000 in revenue from technology licensing components and \$736,000 in revenue from enterprise products. The increase in license revenue in absolute dollars for the nine months ended April 30, 2005 as compared with that for the corresponding period of fiscal 2004 reflected an increase of \$6,536,000 in revenue from enterprise products and an increase of \$1,790,000 in revenue from technology licensing components. A significant portion of the increase in our enterprise revenue was contributed by Synchrologic, Inc. (acquired in December 2003), particularly Intellisync Mobile Suite, and Identity Systems (acquired in March 2004) product sales. The decrease in license revenue as a percentage of total revenue was primarily due to the increase in service revenue in the three and nine months ended April 30, 2005 as described below.

*Service Revenue*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
Service revenue	\$ 5,594	60.1%	\$ 3,495	\$ 15,133	74.1%	\$ 8,690
As percentage of total revenue	36.7%		31.8%	34.6%		29.9%

Service revenue is derived from fees for services, including fixed-price and time-and-materials professional services arrangements and amortization of maintenance contract programs. The increase in service revenue for the three months ended April 30, 2005 as compared with that for the corresponding period of fiscal 2004 resulted from a total increase of \$2,756,000 brought about by an increase in amortization of our maintenance contract programs relating to the increase in license revenue, as well as revenue from our hosting services. This increase was offset by a \$657,000 decrease in professional service revenue associated with our technology licensing partners. The increase in service revenue for the nine months ended April 30, 2005 as compared with that for the corresponding period of fiscal 2004 reflected an increase of \$8,055,000 in revenue from our maintenance contract programs and hosting services, slightly offset by \$1,612,000 decrease in professional service revenue.

In any period, service revenue from time and materials contracts is dependent, among other things, on license transactions closed during the current and preceding quarters and customer decisions regarding implementations of licensed software.





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*Enterprise and Retail Products*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Enterprise and retail products	\$ 7,803	18.7%	\$ 6,576	\$ 25,880	82.6%	\$ 14,172
As percentage of total revenue	51.2%		59.7%	59.1%		48.8%

Our enterprise and retail products revenue includes sales to retail distribution channels, as well as direct sales of our personal and server products licensed to corporations for internal use. Enterprise and retail products include Intellisync Handheld Edition, Intellisync Handheld Edition for Enterprise, Intellisync Phone Edition, Intellisync Mobile Suite and Identity Search Server (formerly Identity Systems), as well as related support and maintenance. Enterprise sales frequently involve large up-front license fees, which can result in lengthy sales cycles and uncertainties as to the timing of sales driven by customers' budgetary processes. As a result, we generally have less visibility into future enterprise sales than is typically the case in our royalty-based technology licensing business. In addition, while enterprise sales generally result in ongoing maintenance revenue and may lead to follow-on purchases or upgrades, we are typically dependent on sales to new customers for a significant portion of our enterprise revenue in a given quarter.

The increase in enterprise and retail products revenue for the three months ended April 30, 2005 as compared with that for the corresponding period of fiscal 2004 resulted from contributions of \$1,503,000 from Identity Systems and Synchrologic products and an increase of \$987,000 in revenue from amortization of support and maintenance based on a higher license revenue base. This increase was slightly offset by a \$1,263,000 decrease in revenue from Intellisync Handheld Edition for Enterprise and in retail sales of our Intellisync software. The increase in enterprise and retail products revenue for the nine months ended April 30, 2005 as compared with that for the corresponding period of fiscal 2004 resulted from contributions of \$9,576,000 from Identity Systems and Synchrologic products and an increase of \$4,948,000 in revenue from amortization of support and maintenance, slightly offset by a \$2,816,000 decrease in revenue from retail sales of our Intellisync software. Less emphasis on marketing of Intellisync Handheld Edition for Enterprise, and more on the transition of our enterprise server offering to Intellisync Mobile Suite, during the most recent quarters contributed to the decrease in revenue from Intellisync Handheld Edition for Enterprise. We expect revenue in absolute dollars from enterprise and retail products to remain at the current level or decrease in the following quarter, which we believe will occur as a result of seasonal factors in the enterprise and retail business inherent with the summer, as well as of continued decrease in revenue related to our legacy products.

*Technology Licensing Components*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Technology licensing components	\$ 7,434	67.8%	\$ 4,431	\$ 17,915	20.6%	\$ 14,854
As percentage of total revenue	48.8%		40.3%	40.9%		51.2%

Technology licensing components include various licensed technology platforms, including Intellisync Mobile Suite, Intellisync goAnywhere, Intellisync Software Development Platform, Intellisync Server-to-Server, professional services, non-recurring engineering services and related maintenance contract programs. The increase in technology licensing revenue for the three months ended April 30, 2005 as compared with that

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for the corresponding period of fiscal 2004 resulted from contributions of \$3,164,000 from Intellisync Software Development Platform and hosting service revenue, offset slightly by a \$161,000 decrease in revenue from professional services. Revenue from hosting services grew in the quarter through a combination of growth from existing carrier customers and the signing of several new carrier contracts during the quarter. The increase in technology licensing revenue for the nine months ended April 30, 2005 as compared with that for the corresponding period of fiscal 2004 resulted from contributions of \$4,896,000 from Intellisync Software Development Platform and

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hosting service revenue, offset slightly by \$1,835,000 decrease in revenue from professional services. We expect that a further increase in revenue from our carrier business during the next quarter will result in an overall increase in our technology licensing revenue as compared with the recent previous quarters.

### *International Revenue*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
International revenue	\$ 4,950	47.8%	\$ 3,349	\$ 14,091	44.7%	\$ 9,735
As percentage of total revenue	32.5%		30.4%	32.2%		33.5%

The year-over-year increase in our international revenue represented 38% and 29% of our total revenue increase for the three and nine months ended April 30, 2005. Our international revenue growth, in absolute dollars, was a result of a number of factors including an increase in the number of our international technology licensing partners, particularly in Europe; the full-quarter and the full nine-month revenue effect of Identity Systems during fiscal 2005; an increase in the number of sales people worldwide; and the effect of foreign exchange translation. The slight decrease in international revenue as a percentage of total revenue for the nine months ended April 30, 2005, on the other hand, is primarily due to increased revenue from our newer offerings in the United States. We expect that our acquisitions of Synchrologic and Identity Systems will further strengthen our presence in Europe, as well as in Asia-Pacific. We believe, however, that international revenue will fluctuate on a quarter to quarter basis as we periodically enter into new agreements for professional services and new international partner contracts for technology licensing. International revenue may be subject to certain risks not normally encountered in operations in the United States, including exposure to tariffs, various trade regulations, fluctuations in currency exchange rates, as well as international software piracy as described more fully in *Factors That May Affect Future Operating Results* set forth below. We believe that continued growth will require further expansion in international markets. We have utilized and will likely continue to utilize substantial resources both to expand and establish international operations in the future.

### *Top Customers*

One customer accounted for 11% of our total revenue for the three months ended April 30, 2005. No customers accounted for more than 10% of our total revenue for the nine months ended April 30, 2005 and for the three and nine months ended April 30, 2004.

### *Cost of Revenue*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Cost of revenue	\$ 2,537	13.4%	\$ 2,237	\$ 7,397	30.5%	\$ 5,667
As percentage of total revenue	16.6%		20.3%	16.9%		19.5%

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Cost of revenue consists of license costs and service costs. License costs comprise product-packaging expenses such as product media and duplication, manuals, packing supplies, and shipping costs. Service costs comprise personnel-related expenses such as salaries and other related costs associated with work performed under professional service contracts, non-recurring engineering agreements, post-sales customer support costs and hosting costs for hosting services associated with technology licensing partners and end users. Hosting costs include expenses related to bandwidth for hosting, tape backup, security and storage, third-party fees and internal personnel costs associated with logistics and operational support of the hosting services. Service costs can be expected to vary significantly from period to period depending on the mix of services we provide.

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In general, license revenue costs represent a smaller percentage of license revenue when compared with service revenue costs as a percentage of service revenue; this is due to the high cost structure of service revenue. Additionally, license costs tend to be variable based on license revenue volumes, whereas service costs tend to be fixed within certain service revenue volume ranges. We would expect that an increase in service revenue as a percentage of our total revenue would generate lower overall gross margins as a percentage of total revenue. Also, given the high level of fixed costs associated with the professional services group and our hosting operations, our inability to generate revenue sufficient to absorb these fixed costs could lead to low or negative service gross margins.

The increase in cost of revenue in absolute dollars reflected the effect of planned increases in mobile hosting and post-sales support infrastructure. The increase in overall revenue contributed to improvement in our gross margins for the three and nine months ended April 30, 2005. In future periods, cost of revenue may further fluctuate from quarter to quarter due to potential changes in the infrastructure and other requirements of our hosting operations to meet carriers demand. These changes, which may be costly, are difficult to forecast. In addition, our cost of revenue is primarily driven by our expectation for different margin characteristics within and between license and service revenue as well as the expected mix between products and channels.

### *Amortization of Developed and Core Technology*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Amortization of developed and core technology	\$ 1,187	19.9%	\$ 990	\$ 3,515	127.8%	\$ 1,543
As percentage of total revenue	7.8%		9.0%		8.0%	
					5.3%	

The increase in the amortization of developed and core technology was primarily due to the amortization of the recently purchased technology from Tourmaline, as well as the impact of a full-quarter amortization of the purchased technology from Identity Systems in the three months ended April 30, 2005, and a full-nine months amortization of the purchased technology from Synchrologic and Identity Systems in the nine months ended April 30, 2005. Based on acquisitions completed as of April 30, 2005, we expect the future amortization expense of developed and core technology to be as follows (in thousands):

Three months ending July 31, 2005	\$ 1,183
Fiscal year ending July 31,	
2006	4,624
2007	4,381
2008	2,046
2009	685
2010	456
Thereafter	197
	\$ 13,572

We expect that we may acquire additional developed and core technology associated with any acquisitions we may complete in the future. As a result, we may further increase our amortization expense of developed and core technology.



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*Research and Development*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Research and development	\$ 3,810	9.0%	\$ 3,495	\$ 10,819	33.6%	\$ 8,098
As percentage of total revenue	25.0%		31.8%	24.7%		27.9%

Research and development expenses consist primarily of salaries and other related costs for research and development personnel, quality assurance personnel, product localization, fees to outside contractors and the cost of facilities and depreciation of capital equipment. We invest in research and development both for new products and to provide continuing enhancements to existing products. Our engineering group is currently focused on developing new functionality for wireless handhelds, smartphones, laptops and tablets, at extending our core synchronization technology to increase scalability and extensibility, and at supporting next generation wireless technology and device platforms. The increase in research and development spending in absolute dollars was due to the relative impact of the acquired workforce of approximately six engineers from the acquisition of Tourmaline during the third quarter of fiscal 2005 and 71 engineers from the acquisition of Spontaneous Technology, Inc., Synchrologic and Identity Systems during the first three quarters of fiscal 2004. The decrease in research and development expense as a percentage of revenue was due to an increase in overall revenue.

*Sales and Marketing*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Sales and marketing	\$ 8,209	78.0%	\$ 4,612	\$ 20,055	75.0%	\$ 11,463
As percentage of total revenue	53.9%		41.9%	45.8%		39.5%

Sales and marketing expenses consist primarily of salaries, commissions, promotional expenses (marketing and sales literature and presentations), marketing programs (trade shows, public relations) and other costs relating to sales and marketing employees, as well as to technical support personnel associated with pre-sales activities such as building brand awareness, performing product and technical presentations and answering customers' product and service inquiries. Sales and marketing expenses increased year-over-year as a result of an increase in number of sales people worldwide and in sales commissions effecting an increase in personnel costs of \$1,783,000 and \$5,127,000 for the three and nine months ended April 30, 2005, respectively. We acquired 22 new sales and marketing employees from Synchrologic and 11 from Identity Systems during fiscal 2004. The increase in sales and marketing expenses was also due to an increase in marketing programs and other related activities of approximately \$1,421,000 and \$2,696,000 to support increased revenue activities driven by our recent acquisitions and establishing strategic relationships with our existing and prospective enterprise customers. Consequently, sales and marketing-related travel increased by approximately \$393,000 and \$769,000, respectively. We intend to increase awareness and market presence of our existing and new products, services or technology over time, which may require us to substantially increase the amount we spend on sales and marketing in future periods. We expect that these expenses will continue to increase as we increase our sales and marketing efforts and sales team worldwide.

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General and Administrative

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
General and administrative	\$ 2,221	40.4%	\$ 1,582	\$ 6,383	8.3%	\$ 5,894
As percentage of total revenue	14.6%		14.4%	14.6%		20.3%

General and administrative expenses consist primarily of salaries and other costs relating to administrative, executive and financial personnel and outside professional fees. The increase in general and administrative spending for the three months ended April 30, 2005 was due to an increase of \$473,000 in personnel costs which resulted from hiring three additional staff, not including consultants, and the absence of approximately \$205,000 recovery of stock compensation charge we had in the third quarter of fiscal 2004. The increase was also due to an increase in outside professional services and other costs of \$166,000 associated mainly with the Sarbanes-Oxley compliance. The increase in general and administrative spending for the nine months ended April 30, 2005 was due to the costs of Sarbanes-Oxley compliance, the three additional staff, not including consultants, and other costs of \$2,018,000. This increase was offset by certain costs incurred in fiscal 2004 that were diminished in the first quarter of fiscal 2005. Such costs include a significant non-cash variable accounting charge of \$667,000 associated with certain outstanding stock options and outside services costs brought about primarily by legal costs of \$862,000 associated with certain patent infringement lawsuits that have been resolved. The decrease in general and administrative expense as a percentage of revenue for the nine months ended April 30, 2005 was due to an increase in overall revenue.

Depending on the degree of the fluctuation of our stock price in the future, we may incur a significant variable accounting charge or a recovery of charges from prior quarters associated with certain employee stock options. The charge or the recovery may increase or decrease our total general and administrative costs in the next few quarters. The charge or the recovery may also further increase or offset our expected total cost of revenue, research and development and sales and marketing costs in the near future.

In addition, the FASB issued in December 2004 Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95*, that addresses the accounting treatment for employee stock options and other share-based payment transactions. The statement generally would require that share-based compensation transactions be accounted for using a fair-value-based method and recognized as expenses. The statement and the change in accounting treatment could result in our reporting increased operating expenses starting August 1, 2005. Refer to the caption *Recently Issued Accounting Pronouncements* set forth below for further details on SFAS No. 123R.

Amortization of Other Intangibles

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Amortization of other intangibles	\$ 1,074	58.2%	\$ 679	\$ 3,176	216.7%	\$ 1,003
As percentage of total revenue	7.0%		6.2%	7.2%		3.5%





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The increase in the amortization of other intangibles was primarily due to the impact of recently acquired intangibles from Tourmaline, as well as the relative impact of intangibles acquired from Spontaneous Technology, Synchrologic and Identity Systems during fiscal 2004. Based on acquisitions completed as of April 30, 2005, we expect the future amortization expense of other intangible assets is as follows (in thousands):

Three months ending July 31, 2005	\$ 1,056
Fiscal year ending July 31,	
2006	3,614
2007	3,076
2008	1,793
2009	955
2010	679
Thereafter	1,131
	\$ 12,304

We expect that we may acquire additional intangibles associated with any acquisitions we may complete in the future. As a result, we may further increase our amortization expense of other intangibles.

### *In-Process Research and Development*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
(In thousands, except percentage)						
In-process research and development	\$	N/A	\$ 775	\$	N/A	\$ 3,667
As percentage of total revenue		%	7.0%		%	12.6%

In the three and nine months ended April 30, 2004, we recorded a charge of \$775,000 and \$3,667,000, respectively, for in-process research and development associated with the acquisition of Identity Systems in the third quarter of fiscal 2004, Synchrologic in the second quarter of fiscal 2004 and of Spontaneous Technology in the first quarter of fiscal 2004. The purchase prices of Identity Systems, Synchrologic and Spontaneous Technology were assigned to the fair value of the assets acquired, including the in-process research and development. As of the acquisition dates of the three companies, technological feasibility of the in-process technology had not been established and the technology had no alternative future use. Accordingly, we expensed the in-process research and development at the date of the acquisitions.

The amount of the purchase price allocated to in-process research and technology was based on established valuation techniques used in the high-technology software industry. The fair value assigned to the acquired in-process research and development was determined using the income approach, which discounts expected future cash flows to present value. The key assumptions used in the valuation include, among others, expected completion date of the in-process projects identified as of the acquisition date, estimated costs to complete the projects, revenue contributions and expense projections assuming the resulting product has entered the market, and discount rate based on the risks associated with the development life cycle of the in-process technology acquired. The discount rate used in the present value calculations is normally obtained from a weighted-average cost of capital analysis, adjusted upward to account for the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technology, and the uncertainty of technological advances that could potentially impact the estimates. We assumed the pricing model for the resulting product of the acquired in-process research and technology to be standard within its industry. We, however, did not take into consideration any consequential amount of expense reductions from integrating the acquired in-process technology with other existing in-process or completed technology. Therefore, the valuation assumptions do not include significant anticipated cost savings.



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The key assumptions underlying the valuation of acquired in-process research and development were as follows (in thousands):

### *Identity Systems*

Project names: SSA-NAME3 Version 3.0 and IDS Version 3.0

Percent completed as of acquisition date: 10%

Estimated costs to complete technology at acquisition date: \$600,000

Risk-adjusted discount rate: 25%

First period expected revenue: June 2005

### *Synchrologic*

Project names: Version upgrade of Data Sync, File Sync, E-mail Accelerator and Systems Management products

Percent completed as of acquisition date: 60%-70%

Estimated costs to complete technology at acquisition date: \$3,000,000

Risk-adjusted discount rate: 22%

First period expected revenue: calendar year 2004

### *Spontaneous Technology*

Project names: Version upgrade of Spontaneous Technology's secure Virtual Private Network (sVPN)

Percent completed as of acquisition date: 60%

Estimated costs to complete technology at acquisition date: \$125,000

Risk-adjusted discount rate: 22%

First period expected revenue: calendar year 2004

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The development of the above technologies were highly dependent on the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for a new product, and significant competitive threats from several companies. The nature of the efforts to develop this technology into a commercially viable product consisted primarily of planning, designing, experimenting, and testing activities necessary to determine that the technology could meet market expectations, including functionality and technical requirements. Failure to bring the product to market in a timely manner could have resulted in a loss of market share or a lost opportunity to capitalize on emerging markets, and could have a material adverse impact on our business and operating results.

Subsequent to the acquisition of Identity Systems, Synchrologic and Spontaneous Technology, there have been no significant developments related to the current status of the acquired in-process research and development project that would result in material changes to the assumptions.

### *Other Charges*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Other charges	\$	N/A	\$ 253	\$	N/A	\$ 929
As percentage of total revenue		%	2.3%		%	3.2%

*Facilities Exit Costs and Restructuring Accrual.* During the third quarter of fiscal 2004, we implemented a reduction in workforce affecting 17 employees in various business functions (9 in research and development and 8 in sales and marketing). The program was completed by the end of April 2004, and the associated severance costs incurred were approximately \$253,000, none of which remained unused as of April 30, 2005.

During the three months ended January 31, 2004, we recorded facilities exit costs of \$600,000 for vacating our remaining office space in Santa Cruz, California and a floor of our office facility in San Jose,

California. Inherent in the estimation of the costs related to our restructuring efforts are assessments related to the most likely expected outcome of the significant actions to accomplish the restructuring. In determining the excess facilities exit costs, we were required to estimate future sublease income, negotiated lease settlement costs, future net operating expenses of the facilities, and brokerage commissions, among other expenses. These estimates, along with other estimates made by management in connection with restructuring, may vary significantly depending, in part, on factors that may be beyond our control. Specifically, these estimates will depend on our success in negotiating with lessors, the time periods required to locate and contract suitable subleases and the market rates at the time of such subleases. Adjustments to the reserve for the consolidation of excess facilities will be required if actual lease exit costs or sublease income differ from amounts currently expected.

The following table sets forth the activities in the restructuring accrual account for the nine months ended April 30, 2005 (in thousands):

	Consolidation of Excess Facilities	
<b>Balance at July 31, 2004</b>	\$	1,080
Cash payments		(330)
<b>Balance at October 31, 2004</b>	\$	750
Cash payments		(218)
<b>Balance at January 31, 2005</b>	\$	532
Cash payments		(225)
<b>Balance at April 30, 2005</b>	\$	307

The remaining unpaid amount as of April 30, 2005 of \$307,000 related to the net lease expense due to the consolidation of excess facilities, will be paid over the respective lease terms through June 2006 using cash from operations. The current and long-term portions of the restructuring accrual of \$267,000 and \$40,000 are classified as Accrued Liabilities and Other Liabilities, respectively, in the condensed consolidated balance sheet as of April 30, 2005.

We continually evaluate the balance of the restructuring reserve it records in prior periods based on the remaining estimated amounts to be paid. Differences, if any, between the estimated amounts accrued and the actual amounts paid will be reflected in operating expenses in future periods.

*Other Charges.* During the first quarter of fiscal 2004, we incurred residual costs of approximately \$76,000 for operating expenses, mainly legal and accounting, relating to an acquisition that we ceased pursuing.

#### *Interest Income*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
Interest income	\$ 304	77.8%	\$ 171	\$ 813	98.3%	\$ 410
As percentage of total revenue	2.0%		1.6%	1.8%		1.4%

(In thousands, except percentage)

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Interest income represents interest earned on cash and short-term investments and realized gains on miscellaneous investments. The increase in net interest income was due to an increase in balances of cash and investments mainly from the realized proceeds from issuance of convertible senior notes during fiscal 2004.

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*Interest Expense*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Interest expense	\$ (389)	(292.9)%	\$ (99)	\$ (907)	(816.2)%	\$ (99)
As percentage of total revenue	(2.6)%		(0.9)%	(2.1)%		(0.3)%

Interest expense for three and nine months ended April 30, 2005 and 2004 reflects interest charge associated with the convertible senior notes we issued in March 2004.

*Other, Net*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Other, net	\$ (158)	(59.6)%	\$ (99)	\$ (625)	(626.7)%	\$ (86)
As percentage of total revenue	(1.0)%		(0.9)%	(1.4)%		(0.3)%

Other, net, represents amortization of debt issuance costs, miscellaneous bank fees and charges and realized gain or loss on foreign exchange and investments. Other, net, for the three and nine months ended April 30, 2005 reflects \$175,000 and \$495,000, respectively, of debt issuance costs amortization expense associated with the convertible senior notes we issued in March 2004 and net other income of \$17,000 and net other expense of \$130,000, respectively, of bank charges and investment management fees, net realized gain on foreign exchange and other expenses.

*Litigation Settlement Gain, Net*

	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Litigation settlement gain, net	\$	N/A	\$ 1,576	\$	N/A	\$ 1,576
As percentage of total revenue	%		14.3%	%		5.4%

The gain of \$1,576,000, net of \$424,000 related expenses incurred, in the third quarter of fiscal 2004 resulted from the settlement of litigation against Extended Systems.

*Provision for Income Taxes*



	Three Months Ended April 30,			Nine Months Ended April 30,		
	2005	Percent Change	2004	2005	Percent Change	2004
	(In thousands, except percentage)					
Provision for Income Taxes	\$ (317)	170.9%	\$ (117)	\$ (572)	120.0%	\$ (260)
As percentage of total revenue	(2.1)%		(1.1)%	(1.3)%		(0.9)%

The provision for income taxes primarily represents foreign withholding taxes on royalties earned from certain foreign customers and state franchise and income taxes and estimated taxes for foreign subsidiaries.

**The increase in the provision for income taxes for the three and nine months ended April 30, 2005 was due to an increase in our international operations as a result of our acquisitions and related increase in their net operating income.**

The provision for income taxes primarily represents foreign withholding taxes on royalties earned from certain foreign

**Recently Issued Accounting Pronouncements**



*Other-Than-Temporary Impairment*

In March 2004, the Emerging Issues Task Force Issue (EITF) reached consensus on Issue 03-01, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. EITF No. 03-01 includes new guidance for evaluating and recording impairment losses on debt and equity investments, as well as new disclosure requirements for investments that are deemed to be temporarily impaired. The disclosure requirements are effective for fiscal years ending after June 15, 2004. We have adopted the disclosure requirements in fiscal 2004 accordingly and incorporated such disclosures in note 3 to consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended July 31, 2004. The accounting guidance of EITF No. 03-01 is applicable for reporting periods after June 15, 2004. However, the effective date of such guidance has been delayed until the Financial Accounting Standards Board (FASB) issues a Staff Interpretation on this matter. The delay does not have a specified date. Until an effective date is determined, existing guidance continues to apply in determining if an impairment is other than temporary. We will evaluate the impact of EITF No. 03-01 once final guidance is issued.

*Contingently Convertible Debt on Diluted Earnings per Share*

In October 2004, the EITF reached a consensus on EITF No. 04-8 *The Effect of Contingently Convertible Debt on Diluted Earnings per Share*, that the dilutive effect of contingent convertible debt instruments (CoCos) must be included in diluted earnings per share regardless of whether the triggering contingency has been satisfied, if dilutive. Adoption of EITF No. 04-08 would be on a retroactive basis and would require restatement of prior period diluted earnings per share, subject to certain transition provisions. It is effective for all periods ending after December 15, 2004. Due to the losses we incurred for the three and nine months ended April 30, 2005, diluted net loss per share does not differ from basic net loss per share, since potential shares of common stock issuable upon the conversion of the convertible debt are anti-dilutive for all periods presented. EITF No. 04-8 could have a future impact on our results of operations in the event that the potential shares of common stock issuable upon conversion of the convertible debt were included in the diluted earnings per share calculation.

*Inventory Costs*

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs - an amendment of ARB No. 43, Chapter 4*, that requires that items such as idle facility expense, excessive spoilage, double freight and handling costs be recognized as current period charges. In addition, it requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective in fiscal years beginning after June 2005. We expect SFAS No. 151 to have no material effect on our consolidated financial statements.

*Discontinued Operations*

In November 2004, the EITF reached a consensus on No. 03-13, *Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations*. EITF No. 03-13 relates to components of an enterprise that are either disposed of or classified as held for sale in fiscal periods beginning after December 15, 2004. EITF No. 03-13 allows significant events or circumstances that occur after the balance sheet date but before the issuance of financial statements to be taken into consideration in the evaluation of whether a component should be presented as discontinued or continuing operations, and modifies assessment period guidance to allow for an assessment period greater than one year. The consensus in EITF No. 03-13 was effective for us beginning February 1, 2005. The impact to us of adopting EITF Issue No. 03-13 will depend on the nature and extent of any long-lived assets disposed of or held for sale after the effective date, but we do not currently expect EITF No. 03-13 to have a material impact on our consolidated results of operations, cash flows or financial position.



*Exchanges of Nonmonetary Assets*

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions*. SFAS No. 153 states that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, SFAS No. 153 eliminates the narrow exception for nonmonetary exchanges of similar productive assets and replaces it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of SFAS No. 153 shall be applied prospectively. We do not believe the adoption of SFAS No. 153 will have a significant impact on our consolidated results of operations or financial position.

*Share-Based Payment*

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment, an amendment of FASB Statements No. 123 and 95*. The principal effect of SFAS No. 123R will be to require the inclusion in the earnings of a compensation expense for stock option grants and employee stock plan purchases that previously was only reported as a disclosure in a note to our consolidated financial statements. We are required to adopt the provisions of SFAS No. 123R as of August 1, 2005 but may elect to early adopt the provision effective the first day of any quarter prior to that date. We are presently studying SFAS No. 123R and have not yet determined which method we will select for our adoption of SFAS No. 123R, which we expect to have a potential material impact on our annual earnings.

Staff Accounting Bulletin (SAB) No. 107, *Share-Based Payment*. On March 29, 2005, the SEC staff issued SAB No. 107 to express the views of the staff regarding the interaction between SFAS No. 123R and certain SEC rules and regulations and to provide the staff's views regarding the valuation of share-based payment arrangements for public companies. We are currently in the process of implementing SFAS No. 123R, effective as of August 1, 2005, and will take into consideration the additional guidance provided by SAB No. 107 in connection with the implementation of SFAS No. 123R.

*Tax Deduction Provided For In the American Jobs Creation Act of 2004*

In December 2004, the FASB issued FASB Staff Position No. 109-1, *Application of SFAS No. 109 to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004*. This staff position provides guidance for the accounting of a deduction provided to U. S. manufacturing companies and is effective immediately. We believe the adoption of this position currently will not have a material effect on our financial position or results of operations due to our net operating losses. However, there is no assurance that there will not be a material impact in the future.

*Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*

In December 2004, the FASB issued FASB Staff Position No. 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004*. The American Jobs Creation Act introduces a special one-time dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. This position provides accounting and disclosure guidance for the repatriation provision. We do not believe the Foreign Earnings Repatriation

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Provision within the American Jobs Creation Act of 2004 nor will the FASB Staff Position have a material impact on our financial condition or results of operations.

*Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143*

In March 2005, the FASB issued Interpretation (FIN) No. 47, *Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143*. FIN No. 47 clarifies when an entity would be required to recognize a liability for the fair value of an asset retirement obligation that is conditional on a future event if the liability's fair value can be reasonably estimated. Uncertainty surrounding the timing and method of settlement that



may be conditional on events occurring in the future would be factored into the measurement of the liability rather than the recognition of the liability. FIN No. 47 is effective for fiscal years ending after December 15, 2005. We are currently assessing the impact that the interpretation may have on our consolidated financial position and results of operations.

## Liquidity and Capital Resources

### Working Capital

The following summarizes our cash and cash equivalents, short-term investments and working capital:

	April 30, 2005	Percent Change	July 31, 2004
(In thousands, except percentages and ratios)			
Cash and cash equivalents	\$ 23,910	84.1%	\$ 12,991
Short-term investments	\$ 23,235	(42.9)%	\$ 40,657
Working capital	\$ 46,041	(10.9)%	\$ 51,693
Current ratio	4.0		4.5

We invest excess cash in fixed income securities that are highly liquid, of high-quality investment grade. We intend to make such funds readily available for operating purposes, if needed. In addition to the above cash, cash equivalents and short-term investments at April 30, 2005, we have a total of \$3,797,000 restricted cash that is pledged as collateral for certain stand-by letters of credit issued by certain financial institutions and collateral to match any unfavorable mark-to-market exposure on an interest swap agreement. Refer to the discussion under the caption *Restricted Cash* set forth below for more information.

The significant factors underlying the decrease in cash, cash equivalents and investments during the first three quarters of fiscal 2005 were the acquisition of Tourmaline for \$4,095,000, net cash flow used in operations of \$1,849,000 and capital acquisitions of \$1,412,000, slightly offset by the proceeds from stock issuance of \$1,204,000.

### Cash Flows

*Operating Activities.* Cash flows from operating activities are as follows (in thousands):

	Nine Months Ended April 30,		
	2005	Change	2004
Net cash used in operating activities	\$ (1,849)	\$ 5,907	\$ (7,756)

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The majority of cash applied to cash working capital for the current fiscal year resulted from a decrease in accrued liabilities of \$1,553,000 and an increase in accounts receivable of \$1,081,000 for the first three quarters of fiscal 2005. Accrued liabilities decreased due to the use of restructuring accrual, the timing of commissions and bonus payments, and lower accruals. We have not experienced any significant trends in accounts receivable other than changes relative to the increase in our revenue. Fluctuations in accounts receivable from period to period relative to changes in revenue are a result of timing of customer invoicing and receipt of payments from customers. Days sales outstanding decreased to 68 days in the current quarter compared with 76 days in the corresponding quarter of fiscal 2004. The majority of cash applied to cash working capital for fiscal 2004 resulted from an increase in accounts receivable of \$1,628,000, as well as decrease in accrued liabilities and accounts payable of \$5,370,000 due to timing of payments particularly of litigation costs and other expenses associated with acquisitions for the first three quarters of fiscal 2004.

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*Investing Activities.* Significant items included in cash flows from investing activities are as follows (in thousands):

	Nine Months Ended April 30,					
	2005		Change		2004	
Net sale/maturities of short-term investments	\$	17,395	\$	37,210	\$	(19,815)
Increase in restricted cash		(61)		3,648		(3,709)
Capital expenditures		(1,412)		(971)		(441)
Acquisitions, net of cash acquired		(4,095)		13,856		(17,951)
Net cash provided by (used in) investing activities	\$	11,827	\$	53,743	\$	(41,916)

The net cash flows provided in investing activities during first three quarters of fiscal 2005 were due primarily to cash movement between investments and cash and cash equivalents, slightly offset by Tourmaline acquisition, capital expenditures and the increase in restricted cash associated with a collateral under an interest rate swap agreement.

On March 1, 2005, we completed our acquisition of all of the issued and outstanding stock of Tourmaline Networks, Inc., a privately held developer and marketer of mobile email based on QUALCOMM's BREW® solution headquartered in San Diego, California. Under the terms of an Agreement and Plan of Merger, dated as of February 9, 2005, the outstanding shares of Tourmaline common stock were converted into the right to receive (i) an aggregate of approximately \$4,118,000 in aggregate initial cash consideration and (ii) an aggregate of up to \$2,881,918 in cash earnout consideration, subject to the deposit of a certain portion of the initial cash consideration and earnout consideration in escrow to be available to compensate Intellisync pursuant to the indemnification obligations of the holders of Tourmaline common stock. The earnout consideration is due and payable shortly following the first anniversary of the acquisition.

*Financing Activities.* Significant items included in cash flows from financing activities are as follows (in thousands):

	Nine Months Ended April 30,					
	2005		Change		2004	
Proceeds from stock option exercises	\$	1,204	\$	(992)	\$	2,196
Proceeds from long-term debt				(60,000)		60,000
Debt issuance costs and repayment of capital lease and other borrowings		(321)		4,339		(4,660)
Net cash provided by financing activities	\$	883	\$	(56,653)	\$	57,536

During the first three quarters of fiscal 2005, cash flow generated from financing activities was primarily from stock option exercises. Our future cash flows from stock options are difficult to project as such amounts are a function of our stock price, the number of options outstanding, and the decisions by employees to exercise stock options. In general, we expect proceeds from stock option exercises to increase during periods in which our stock price has increased relative to historical levels.

Refer to the caption *Commitments* below for more details on the \$60,000,000 convertible senior notes issued in fiscal 2004.

*Commitments*

*Capital Leases.* During the first quarter of fiscal 2005, we entered into a capital lease agreement for computer peripherals, which expires in September 2007. In addition, during fiscal 2004, we entered into a capital lease agreement for a phone system, which expires in February 2008. Current and long-term portions of the capital leases amounted to \$149,000 and \$250,000, respectively, at April 30, 2005.

*Operating Leases.* We lease our facilities under operating leases that expire at various dates through December 2008. The leases provide for escalating lease payments.

*3% Convertible Senior Notes.* **During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of convertible senior notes to qualified institutional buyers in reliance on Rule 144A under the Securities Act. The notes are convertible into shares of our common stock at any time prior to the close of business on the final maturity date of the notes, subject to prior redemption of the notes. The initial conversion rate is 250.0000 shares per each \$1,000 principal amount of notes which represents an initial conversion price of \$4.00 per share. The conversion rate is subject to adjustment for certain events, including the payment of dividends, and other events specified in the indenture. The notes bear interest at a rate of 3% per annum. Interest on the notes will be paid on March 1 and on September 1 of each year.**

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*Interest Rate Swap.* During fiscal 2004, we entered into two interest rate swap agreements with a financial institution on a total notional amount of \$60,000,000, whereby we receive fixed-rate interest of 3% in exchange for variable interest payments. The interest rate swaps expire upon the maturity of the \$60,000,000, 3% convertible senior notes in March 2009, and effectively convert fixed-rate notes into variable-rate borrowings. The interest rate is reset semi-annually and is equal to the 6-month LIBOR rate less a rate spread. The total variable interest rate, approximately 2.9% at April 30, 2005, resulted in interest expense savings relative to fixed rates of approximately \$486,000 for the first three quarters of fiscal 2005. Under the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, this arrangement has been designated and qualifies as an effective fair value hedge of interest rate risk related to the \$60,000,000 convertible senior notes. As the terms of the swaps match those of the underlying hedged debt, the changes in the fair value of these swaps are offset by corresponding changes in the carrying value of the hedged debt, and therefore does not impact our net earnings. As of April 30, 2005, the fair value of the interest rate swaps was approximately \$2,116,000 and recorded in *Other Liabilities* with an equal adjustment recorded to the carrying value of the \$60,000,000 convertible senior notes.

The following table summarizes our material obligations and commitments to make future payments, for which we anticipate using cash from operations, under certain contracts, including long-term debt obligations and operating leases as of April 30, 2005 (in thousands):

			Three months									
			ending									
	Total		July 31, 2005		2006		2007		2008		2009	
Long-term debt(1):												
Principal	\$	60,000	\$		\$		\$		\$		\$	60,000
Interest		9,396				1,947		2,380		2,502		2,567
Capital lease obligation(2)		438		44		177		177		40		
Operating leases:												
Operating leases		5,225		924		2,786		766		544		205
Proceeds from subleases		(162)		(116)		(46)						
Net operating leases		5,063		808		2,740		766		544		205
Total	\$	74,897	\$	852	\$	4,864	\$	3,323	\$	3,086	\$	62,772

(1) Represents our 3% convertible senior notes and the associated interest rate swap. Interest on the senior notes and interest rate swap is payable in cash on March 1 and September 1 of each year. The senior notes mature on March 1, 2009.

(2) Includes interest payments due.

In the event of early termination of our service agreement with e deltacom, a division of ITC^DeltaCom, Inc. and a managed service provider, we may be required to pay e deltacom a penalty fee of up to approximately \$45,000.

*Capital Expenditures*

We expect total capital expenditures of approximately \$600,000 for the three months ending July 31, 2005 principally for support of the hosting operations and purchase of computers and other various system upgrades.

3% Convertible Senior Notes. During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of

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### *Restricted Cash*

We have three letters of credit that collateralize certain operating lease obligations and total approximately \$369,000 and \$397,000 at April 30, 2005 and July 31, 2004, respectively. We collateralize these letters of credit with cash deposits made with three of its financial institutions and has classified the short-term and the long-term portions of approximately \$187,000 and \$182,000 at April 30, 2005, and \$101,000 and \$296,000 at July 31, 2004 as Other Current Assets and Restricted Cash, respectively, in the condensed consolidated balance sheets. The long-term portion expires through June 2006. The holders of the letters of credit are able to draw on each respective letter of credit in the event that we are found to be in default of its obligations under each of its operating leases.

Under the terms of the interest rate swap agreement into which we entered during fiscal 2004, we must provide collateral to match any unfavorable mark-to-market exposure (fair value) on the swap. The amount of collateral required totals a minimum of \$1,800,000 plus an amount equal to the unfavorable mark-to-market exposure on the swap. Generally, the required collateral will rise as interest rates rise. As of April 30, 2005, and July 31, 2004, we have posted approximately \$3,797,000 and \$3,736,000, respectively, of collateral under this swap agreement which is included in Restricted Cash in its condensed consolidated balance sheet.

### *Litigation*

In August 2004, a patent-infringement claim was filed against us by NCR Corporation in the U.S. District Court for the Southern District of Ohio. In the complaint, NCR alleged certain of our products infringe three of its patents which cover technology for synchronizing databases between personal digital assistants and host computers. Based on a lengthy review, we believe that NCR's claims against it are without merit and we do not infringe on any of the asserted NCR patents. We do not believe that the outcome of this patent infringement claim, even if adverse to us, would have a material adverse effect on our results of operations and financial condition. Separately, on September 9, 2004, we filed a complaint in the U.S. District Court for the Northern District of California against NCR requesting, among other things, that a declaratory judgment be entered finding that we do not infringe an NCR patent (6,473,765) that was asserted against one of our licensees, Garmin Ltd. We have certain indemnification obligations to Garmin for claims related to intellectual property infringement. In response, NCR amended its suit against Garmin to withdraw its allegation of infringement of the 765 patent and stated that we have no liability to NCR for infringement of the 765 patent. NCR then moved to dismiss the California case on the basis that, because we could not be sued for infringement, the Court lacked jurisdiction to adjudicate our declaratory judgment action. The motion was granted and the California case was dismissed on November 22, 2004.

We are also involved in various litigation and claims arising in the normal course of business. In management's opinion, these matters are not expected to have a material impact on our consolidated results of operations or financial condition.

We believe that our current cash, cash equivalents and short-term investment balances, including cash generated from operations, if any, will be sufficient to meet our working capital and other cash requirements for at least the next 12 months. Beyond the next 12 months, we expect our cash flow from operations and the remaining proceeds from the convertible senior notes we issued in fiscal 2004 to remain sufficient to fund any ongoing investments in capital equipment and interest payments on our notes. There are no arrangements and other relationships with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of our requirements for capital.

We believe that the most strategic uses of our cash resources include strategic investments to gain access to new technologies, acquisitions, financing activities, and working capital. Therefore, from time-to-time, we may consider additional acquisitions and a wide range of other business opportunities. To the extent that our current cash, cash equivalents and short-term investment balances and cash flow from operations

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are insufficient to fund any new acquisition, business opportunity or venture, as well as to fund future operating requirements, we may seek to raise cash through further issuance of debt or equity securities. We cannot be certain that such financing would be available to us at all, or on terms favorable to us.

### Factors That May Affect Future Operating Results

There are many factors that affect our business and the results of our operations, some of which are beyond our control. The following is a description of some of the important factors that may cause the actual results of our operations in future periods to differ materially from those currently expected or desired.

*We have historically incurred losses and we expect these losses to continue in the future. We may not be able to sustain consistent future revenue growth on a quarterly or annual basis, or achieve or maintain profitability.*

We have not been profitable since fiscal 1998. We cannot be certain that our revenue will continue to grow or remain at the same level, or that our revenue will not decline in the future. We have experienced losses of \$4,361,000 and \$8,841,000 for the three and nine months ended April 30, 2005, respectively, and \$2,184,000 and \$7,697,000 for the corresponding periods in fiscal 2004. At April 30, 2005, we had an accumulated deficit of \$140.0 million. To become profitable and sustain profitability, we will need to generate additional revenue to offset our expenses. We may not achieve or sustain revenue growth and our losses may continue or increase in the future. The synchronization market is new and evolving, and as a result we cannot accurately predict either the future growth rate, if any, or the ultimate size of the market for our products and services. Because our operating expenses are relatively fixed in the short term, any shortfalls in revenue would materially affect our results of operations.

*Our quarterly revenue and operating results are subject to significant fluctuations, and our stock price may decline if we do not meet the expectations of investors and analysts.*

Our quarterly revenue and operating results are difficult to predict and have and may in the future fluctuate significantly from quarter to quarter due to a number of factors, many of which are outside our control. These factors include, but are not limited to:

market acceptance of products in which our software is integrated by original equipment manufacturers, or OEMs;

growth in the market for enterprise synchronization applications and our ability to successfully address this market;

our reliance on international sales and growth;

our ability to penetrate the international market;

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our ability to realize our goals with respect to recent and potential future acquisitions;

our need and ability to generate and manage growth;

rapid evolution of technology;

our evolving business model;

litigation-related expenses;

fluctuations in gross margins;

the seasonal nature of the market for some of our products;

changes in the market for mobility and identity search/screening software;

introduction of new products and services by us or our competitors;

the recent decline in the market for traditional personal digital assistants;

changes in our mix of sources of revenue; and

entrenched and substantial competition.

Additionally, we generally derive our technology licensing revenue from multi-year contracts with enterprise and other customers that frequently include license fees, professional services fees, royalty payments and maintenance. We typically earn both the license fees and the professional services in the initial one or two quarters subsequent to the signing of a contract. We periodically have large professional services implementations that individually contribute as much as 5% or more to quarterly revenue. Combined with related license revenue, total revenue from individual customers in the initial quarters of a contract may exceed the revenue we earn during subsequent periods covered by the contract. To the extent that we do not secure additional contracts with the same customer or secure comparably sized commitments from other customers, we may not be able to sustain or grow our revenue.

***If we fail to develop and sell products designed for OEMs, enterprises and mobile carriers, our revenue and operating results will be adversely affected.***

We have recently made substantial investments to develop and offer an expanded range of enterprise synchronization applications, including our acquisition of Synchronologic and Identity Systems. Our operating plans assume revenue growth from the enterprise market. Enterprise sales present a variety of challenges that are different from those inherent in our historical licensing and consumer business model, and we have limited experience addressing these challenges. For example, enterprise sales typically involve large up-front license fees, which can result in lengthy sales cycles and uncertainties as to the timing of sales driven by customers' budgetary processes. As a result, we generally have less visibility into future enterprise sales than is typically the case in our royalty-based technology licensing business. In addition, while enterprise sales generally result in ongoing maintenance revenue and may lead to follow-on purchases or upgrades, we are typically dependent on sales to new customers for a significant portion of our enterprise revenue in a given quarter. If our product and service offerings fail to achieve market acceptance, or if enterprise sales fail to meet our expectations in a particular quarter, our revenue and operating results may be materially and adversely affected.

***Our business and prospects depend, to a significant degree, on demand for wireless and other mobile computing devices.***

The use of wireless and other mobile computing devices for retrieving, sharing and transferring information among businesses, consumers, suppliers and partners has begun to develop only in recent years. Our success will depend in large part on continued growth in the use of wireless and other mobile computing devices, including handheld computers, smart phones, pagers and other mobile devices. In addition, our markets face critical unresolved issues concerning the commercial use of wireless and other mobile computing devices, including security, reliability, cost, ease of access and use, quality of service, regulatory initiatives and necessary increases in bandwidth availability. Demand for, and market acceptance of, wireless and other mobile computing devices which require our products and services are subject to a high level of

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uncertainty and are dependent on a number of factors, including:

growth in sales of handheld devices, smart phones and other mobile computing devices supported by our software and growth in wireless network capabilities to match end-user demand and requirements;

emergence of a viable and sustainable market for wireless and mobile computing services;

our product and service differentiation and quality;

the development of technologies that facilitate interactive communication between organizations;

our distribution and pricing strategies as compared with those of our competitors;

the growth in access to, and market acceptance of, new interactive technologies;

increases in bandwidth for data transmission;

the effectiveness of our marketing strategy and efforts;

our industry reputation; and

general industry and economic conditions such as slowdowns in the computer or software markets or the economy in general.

If the market for wireless and other mobile computing devices as a commercial or business medium does not develop, or develops more slowly than expected, our business, results of operations and financial condition will be seriously harmed.

Even if the wireless and mobile computing services market does develop, our products and services may not achieve widespread market acceptance. If our target customers do not adopt, purchase and successfully deploy our other current and planned products and services, our revenue will not grow significantly and our business, results of operations and financial condition will be seriously harmed.

***If we fail to complete our internal control evaluations or if our independent registered public accounting firm does not attest to our evaluation in a timely manner, we could be subject to regulatory scrutiny and a loss of public confidence in our internal controls.***

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 ( Section 404 ), we have begun to perform an evaluation of our internal controls over financial reporting and are required to have our independent registered public accounting firm test and evaluate the design and operating effectiveness of such internal controls and publicly attest to such evaluation in our annual report on Form 10-K for our fiscal year ending July 31, 2005. We have prepared an internal plan of action for compliance with the requirements of Section 404, which includes a timeline and scheduled activities, although as of the date of this filing we have not yet completed the evaluation. Compliance with the requirements of Section 404 is expected to be expensive and time-consuming, and may require us to increase staffing levels. If we fail to complete this evaluation in a timely manner, or if our independent registered public accounting firm cannot attest in a timely manner to our evaluation, we could be subject to regulatory scrutiny and a loss of public confidence in our internal controls. In addition, any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations.

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In addition, our recent acquisitions of companies, some of which have operations outside the United States, provided us with challenges in implementing the required processes and procedures in our acquired operations. Acquired companies may not have disclosure controls and procedures or internal control over financial reporting that are as thorough or effective as those required by securities law in the United States. We, therefore, intend to devote substantial time and have incurred and will continue to incur substantial costs during fiscal 2005 to ensure ongoing compliance. We cannot, however, be certain that we will be successful in complying with Section 404.

*We are placing increasing emphasis on our hosting services, of which potential growth may be difficult to manage effectively, and, as a result, our results of operations could be adversely affected.*

We are increasingly focusing our sales and marketing and engineering efforts on hosting services. This focus may cause increased business risks associated specifically with our ability to manage the level of complexity involved in executing successfully our strategies to provide superior services for mobile carriers. The rapid growth of our hosting business may place a significant strain on our management, operations and resources. Our future performance and profitability will depend on our ability to:

increase our capital investments and further build our infrastructure to meet the demands of our carrier customers;

maintain technical capabilities to compete effectively in the hosting business; and

effectively oversee and manage our outsourced hosting center.

There can be no assurance that our systems, procedures and controls will be adequate to support rapid expansion of our hosting services. If we are unable to manage such growth successfully, our business and results of operations could be harmed.

*We expect that we may become increasingly dependent on mobile carriers for the success of our wireless software.*

The success of our wireless business strategy is increasingly becoming dependent on our ability to establish new relationships and build on our existing relationships with domestic and international mobile carriers. We cannot assure you that we will be successful in establishing new relationships or advancing existing relationships with mobile carriers or that these mobile carriers will act in a manner that will promote the success of our wireless products. Factors that are largely within the control of mobile carriers but which are important to our success, include:

the degree to which mobile carriers facilitate the introduction of and actively promote, distribute and resell our products;

testing of our products on mobile carriers' networks;

quality and coverage area of wireless services offered by the mobile carriers;

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the extent to which mobile carriers require specific hardware and software features on our products to be used on their networks;

contractual terms and conditions imposed on us by mobile carriers that, in some circumstances, could limit our ability to make similar products available through competitive carriers in some market segments; and

mobile carriers' pricing requirements and subsidy programs.

Mobile carriers have significant bargaining power as we negotiate agreements with them. They could require contract terms that are difficult for us to meet and could result in higher costs to complete certification requirements and negatively impact our results of operations and financial condition. Mobile carriers also place significant conditions on our ability to develop and launch products for use on their wireless networks. If we fail to address the needs of mobile carriers, identify new product and service opportunities or modify or improve our products in response to changes in technology, industry standards or mobile carrier requirements, our products could rapidly become less competitive or obsolete. If we fail to timely develop products that meet carrier product planning cycles or fail to deliver sufficient quantities of products in a timely manner to mobile carriers, those carriers may choose to

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offer similar products from our competitors and thereby reduce their focus on and cease offering our products which would have a negative impact on our business, results of operations and financial condition.

In addition, the potential rapid growth of our business, as we become more dependent on mobile carriers, may place a strain on our management, operations, employees, or resources. We may not be able to maintain a rapid growth rate, effectively manage our expanding operations, or achieve planned growth on a timely or profitable basis. If we are unable to manage our growth effectively, we may experience operating inefficiencies, and our net income may be materially adversely affected.

***Most sales with mobile carriers and enterprises have a long sales cycle process, which increases the cost of completing sales and renders completion of sales less predictable.***

The sales cycle process with mobile carriers could be long, making it difficult to predict the quarter in which we may recognize revenue from a sale, if at all. The general length of the sales cycle increases our costs and may cause license revenue and other operating results to vary significantly from period to period. Our products or technology often are part of significant strategic decisions by our customers regarding their information systems. Accordingly, the decision to license our products typically requires significant pre-purchase evaluation. We spend substantial time providing information to prospective customers regarding the use and benefits of our products. During this evaluation period, we may expend significant funds in sales and marketing efforts. If anticipated sales from a specific customer for a particular quarter are not realized in that quarter, our operating results may be adversely affected.

***Revenue from hosting services may carry lower gross margins and an overall increase in such revenue as a percentage of total revenue could have an adverse impact on our business.***

Our commitment to providing quality services to our enterprise and mobile carrier customers may result in our hosting service revenue having a lower gross margin than other services and license revenue. Due to the lower margin, an increase in the hosting service revenue as a percentage of total revenue could have a detrimental impact on our overall gross margins and could adversely affect operating results. In addition, a change in the mix between services that are provided by our own employees and those services provided by third-party vendors may negatively affect our gross margins.

***System failures or accidental or intentional security breaches could disrupt our operations, cause us to incur significant expenses, expose us to liability and harm our reputation.***

Our operations, including hosting services, depend upon our ability to maintain and protect our computer systems and core business applications, which are located at our offices, as well as hosted by third-party vendors. Although we are taking various precautions to maintain and protect our systems, they could still be vulnerable to damage from break-ins, unauthorized access, vandalism, fire, floods, earthquakes, power loss, telecommunications failures and similar events. We maintain insurance against break-in, unauthorized access, vandalism, fires, floods, earthquakes and general business interruptions. The amount of coverage, however, may not be adequate in any particular case, and will not likely compensate us for all the damages caused by these or similar events. In addition, while we put various security measures in place to detect any unauthorized access to our computers and computer networks, we may be unable to prevent computer programmers or hackers from penetrating our network security or creating viruses to sabotage or otherwise attack our computer networks from time to time. A breach of our security could seriously damage our operations or reputation. In addition, because a hacker who penetrates our network security could misappropriate proprietary information or cause interruptions in our services, we might be required to expend significant resources to protect against, or to alleviate, problems caused by hackers. We might also face liability to persons harmed by misappropriation of secure information if

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it is determined that we did not exercise sufficient care to protect our systems.

Systems failure or damage could cause an interruption of our services and result in loss of customers, difficulties in attracting new customers and could adversely impact our operating results. In addition, if the number of customers who purchase our hosting services increases over time, our systems must be able to accommodate increased usage. If we are unable to increase our capacity to accommodate growth in usage, we could encounter system performance issues, which could harm our relationships with customers and our reputation.

*Our stock price has historically been and may continue to be volatile, which may cause you to lose money and could lead to costly litigation against us that could divert our resources.*

Stock markets have recently experienced dramatic price and volume fluctuations, particularly for shares of technology companies. These fluctuations can be unrelated to the operating performance of these companies. Broad market fluctuations may reduce the market price of our common stock and cause you to lose some or all of your investment. These fluctuations may be exaggerated if the trading volume of our common stock is low. In addition, due to the technology-intensive nature and growth rate of our business and the mobile computing synchronization market, the market price of our common stock has in the past and may in the future rise and fall in response to:

quarterly variations in operating results;

seasonal fluctuations on product sales;

announcements of technological innovations;

announcements of new software or services by us or our competitors;

acquisitions or strategic alliances by us or by our competitors;

commencement or outcome of litigation involving us;

changes in financial estimates by securities analysts; and

other events beyond our control, including general market conditions.

Furthermore, our operating results and prospects from time to time may be below the expectations of public market analysts or investors. Any negative change in the public's perception of companies in the wireless communications market could depress our stock price regardless of our operating results. Recently, companies experiencing high volatility or significant drops in their stock prices have faced securities class action lawsuits when the market price of a stock has been volatile. Holders of that stock have often instituted securities class action litigation against the company that issued the stock when such stock declines. If any of our stockholders brought such a lawsuit against us, we could incur substantial costs defending the lawsuit. The lawsuit could also divert the time and attention of our management. Further, any settlement of such a lawsuit could adversely affect us.

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*We may be unable to adequately protect our proprietary rights.*

The rights we rely upon to protect our intellectual property underlying our products and services may not be adequate, which could enable third parties to use our technology and would reduce our ability to compete in the market. To protect our proprietary rights, we rely on a combination of patent, trademark, copyright and trade secret laws, confidentiality agreements with our employees and third parties, and protective contractual provisions. These efforts to protect our intellectual property rights may not be effective in preventing misappropriation of our technology. These efforts also may not prevent others from developing products or technologies similar to, competitive with, or superior to those we develop. Any of these results could reduce the value of our intellectual property. We may be forced to litigate to enforce or defend our intellectual property rights and to protect our trade secrets. Any such litigation could be very costly and could distract our management from focusing on operating our business. Moreover, our business could be harmed if our patents were determined to be invalid.

*We may be subject to intellectual property infringement claims, which are costly to defend and could limit our ability to use certain technologies in the future.*

Third parties may assert infringement or other intellectual property claims against us. From time to time, we receive notices from third parties alleging that our products or services infringe proprietary rights held by them. For

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example, as we announced in August 2004, NCR Corporation has filed a complaint alleging patent infringement in the U.S. District Court for the Southern District of Ohio Western Division (Dayton). In the complaint, NCR alleges that certain of our products infringe upon three of NCR's patents. Our customers may receive notices of patent or other infringement from third parties and ask for indemnification in the future. We cannot predict whether third parties will assert claims of infringement against us, or whether any past, present or future claims will prevent us from offering products or operating our business as planned.

Separately, on September 9, 2004, we filed a complaint in the U.S. District Court for the Northern District of California against NCR requesting, among other things, that a declaratory judgment be entered finding that we do not infringe an NCR patent (6,473,765) asserted against one of our licensees, Garmin Ltd., and finding that patent to be invalid. In response, NCR amended its suit against Garmin to withdraw its allegation of infringement of the 765 patent and stated that the Company has no liability to NCR for infringement of the 765 patent. NCR then moved to dismiss the California case on the basis that, because the Company could not be sued for infringement, the Court lacked jurisdiction to adjudicate the Company's declaratory judgment action. The motion was granted and the California case was dismissed on November 22, 2004.

Due to the inherently uncertain nature of intellectual property protection and the competitive area in which we operate our business, it is possible that some or all of our products and services could be found to be infringing on the intellectual property of others. We may have to pay substantial damages, including treble damages, for past infringement if it is ultimately determined that our products or services infringe a third party's proprietary rights. We may have to comply with injunctions, or stop distributing our products and services while we re-engineer them or seek licenses to necessary technology, which might not be available on reasonable terms, or at all. We could also be subject to claims for indemnification resulting from infringement claims made against our customers, which could increase our defense costs and potential damages. Even if the claims are without merit, defending a lawsuit takes significant time, may be expensive and may divert management's attention from other business concerns.

***We have been, are and may in the future be involved in litigation that could result in significant costs to us.***

In order to protect our proprietary rights, we may decide to sue other companies. Litigation proceedings are inherently uncertain, and we may not prevail in our defenses or claims. In addition, such litigation is expensive and time-consuming, and management has been in the past and may in the future be required to spend significant time in the prosecution of such suits. If we do not prevail in our claims, we might be forced to accept an unfavorable settlement or judgment and even be required to reimburse other companies in a suit for their legal expenses in defending the suit. An unfavorable settlement or judgment could also materially harm our ability to use existing intellectual property and severely harm our business as a result.

***We face intense competition in the market for mobile computing synchronization products and services, which could reduce our market share and revenue.***

Our market contains few substantial barriers to entry. We believe we will face additional competition from existing competitors and new market entrants in the future. We are subject to current and potential competition with respect to our Intellisync Handheld Edition, Intellisync Handheld Edition for Enterprise, Intellisync Mobile Suite, Intellisync Phone Edition, Intellisync goAnywhere and Identity Search Servers.

Intellisync Mobile Suite enterprise server software CommonTime, Extended Systems, Good Technology, Inc., JP Mobile, Inc., Research In Motion Limited, Sybase Inc.'s iAnywhere, and others.

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Intellisync Mobile Suite and Intellisync goAnywhere software for mobile carriers Good Technology, Inc., Research In Motion Limited, Seven Networks, Inc., Smartner Information Systems Ltd, Visto Corporation, and others.

Intellisync consumer and enterprise desktop sync products Chapura, Inc.'s Pocket Mirror, CommonTime's Cadenza mNotes, Extended Systems, Inc., IBM Corporation, Microsoft Corporation ActiveSync, Palm Desktop from PalmSource, Inc., Sybase Inc.'s iAnywhere, and others.

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Intellisync Phone Edition software FutureDial, Inc.'s SnapSync, Susteen, Inc.'s DataPilot and others.

Identity Search Server Ascential, Dataflux, Firstlogic, Group1, IBM Corporation, Intelligent Search Technology, Language Analysis Systems, Trillium Software, and others.

In addition to the direct competition noted above, we face indirect competition from existing and potential customers that may provide internally developed solutions for each of our technology licensing components. As a result, we must educate prospective customers as to the advantage of our products compared to internally developed solutions. We currently face limited direct competition from major applications and operating systems software vendors who may in the future choose to incorporate data synchronization functionality into their operating systems software, thereby potentially reducing the need for OEMs to include our products in their devices. For example, Microsoft's inclusion of certain features permitting data synchronization between computers utilizing the Windows 2000, Windows Me, Windows NT or Windows XP operating systems, or the Exchange 2003 platform, may have the effect of reducing revenue from our software if users of these operating systems perceive that their data synchronization needs are adequately met by Microsoft.

Many of our competitors have substantially greater financial, technical and marketing resources, larger customer bases, longer operating histories, greater brand recognition and more established relationships in the industry than we do. Our larger competitors may be able to provide customers with additional benefits in connection with their products and costs, including reduced communications costs. As a result, these companies may be able to price their products and services more competitively than we can and respond more quickly to new or emerging technologies and changes in customer requirements. If we are unable to compete successfully against our current or future competitors, we may lose market share, and our business and prospects would suffer.

***Future sales of our common stock, including the shares underlying the convertible senior notes we recently issued, may depress our stock price.***

If our current stockholders sell substantial amounts of common stock in the public market, the market price of our common stock could fall. In addition, these sales of common stock could adversely affect the trading price of our recently issued convertible senior notes and impede our ability to raise funds in the future at an advantageous price, or at all, through another sales of securities.

As of April 30, 2005, we had approximately 66,629,823 shares of common stock outstanding. Assuming that the maximum number of shares and options are issued and registered by us in connection with all of our recent acquisitions and assuming that all shares subject to vested options to purchase common stock under our stock plans are issued, additional shares of our common stock could become issued or issuable and freely tradeable in the public market through approximately April 30, 2006, as follows:

approximately 340,000 shares of our common stock that may be issued in August 2005 and February 2006 under our employee stock purchase plan; and

6,267,281 shares issuable upon exercise of outstanding options that will be vested by April 30, 2006.

3% Convertible Senior Notes. During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of



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In addition, conversion of some or all of the \$60,000,000 aggregate principal amount of convertible subordinated notes that we issued in March 2004 will dilute the ownership interests of investors. Any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices for our common stock.

*If we fail to maintain our existing relationships or enter into new relationships with OEM and business development organizations, or if products offered by our OEM partners fail to achieve or maintain market acceptance, our brand awareness, the sales of our products and use of our services would suffer.*

Our revenue from technology licensing depend, in large part, on our ability to develop and maintain relationships with OEMs and business development organizations that help distribute our products and promote our services. We depend on these relationships to:

distribute our products to purchasers of mobile devices;

increase the use of our technology licensing components;

build brand awareness through product marketing; and

market our products and services cooperatively.

If the products that these equipment manufacturers or business development organizations sell, or if the operating systems upon which these products are based, fail to achieve or sustain market acceptance, or if any of these companies cease to use our product and service offerings in significant volumes, our product sales would decline and our business would suffer. For example, if growth in the number of devices sold by our OEM partners is delayed or did not occur, our business would suffer.

Although several OEMs are subject to certain contractual minimum purchase obligations, we cannot be certain that any particular OEM will satisfy its minimum obligations. Weakening demand from any key OEM and the inability to replace revenue provided by such an OEM could have a material adverse effect on our business, operating results and financial condition. We maintain individually significant receivable balances from major OEMs. If these OEMs fail to meet their payment obligations, our operating results could be materially and adversely affected.

Our agreements with OEMs, distributors, and resellers generally are nonexclusive and may be terminated on short notice by either party without cause. Furthermore, our OEMs, distributors and resellers are not within our control, are not obligated to purchase products from us, and may represent other lines of products, including competing products. A reduction in sales effort or discontinuance of sales of our products by our OEMs, distributors, and resellers could lead to reduced sales and could materially adversely affect our operating results.

*Our market changes rapidly due to evolution in technology and industry standards. If we do not adapt to meet the sophisticated needs of our customers, our business and prospects will suffer.*

3% Convertible Senior Notes. During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of

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The market for our products and services is characterized by rapidly changing technology, evolving industry standards and frequent new product and service introductions. For example, the traditional personal digital assistant market, is declining and may continue to do so. Our future success will depend to a substantial degree on our ability to offer products and services that adapt to these changing markets, incorporate leading technology, address the increasingly sophisticated and varied needs of our current and prospective customers and respond to technological advances and emerging industry standards and practices on a timely and cost-effective basis. Our rapidly evolving market makes it more likely that:

our technology or products may become obsolete upon the introduction of alternative technologies;

we may not have sufficient resources to develop or acquire new technologies or to introduce new products or services capable of competing with future technologies or service offerings of other companies; and

we may not have sufficient resources to develop or acquire new technologies or to introduce new products or services capable of competing with future technologies or service offerings of other companies.

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To the extent we determine that new technologies and equipment are required to remain competitive, the development, acquisition and implementation of these technologies and equipment are likely to continue to require significant capital investment by us. Moreover, we cannot be certain that we can develop, market and deliver new products and technology on a timely basis. Sufficient capital may not be available for this purpose in the future, and even if it is available, investments in new technologies may not result in commercially viable technological processes and there may not be commercial applications for such technologies. If we do not develop, acquire and introduce new products and services and achieve market acceptance in a timely manner, our business and prospects will suffer.

***If we fail to maintain an effective system of internal controls, we may not be able to detect fraud or report our financial results accurately, which could harm our business.***

Effective internal controls are necessary for us to provide reliable financial reports and to detect and prevent fraud. We periodically assess our system of internal controls, and the internal controls of service providers upon which we rely, to review their effectiveness and identify potential areas of improvement. These assessments may conclude that enhancements, modifications or changes to our system of internal controls are necessary. In addition, from time to time we acquire businesses, many of which have limited infrastructure and systems of internal controls. Performing assessments of internal controls, implementing necessary changes, and maintaining an effective internal controls process is expensive and requires considerable management attention, particularly in the case of newly acquired entities. Internal control systems are designed in part upon assumptions about the likelihood of future events, and all such systems, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. If we fail to implement and maintain an effective system of internal controls or prevent fraud, we could suffer losses, could be subject to costly litigation, investors could lose confidence in our reported financial information and our brand and operating results could be harmed, which could have a negative effect on the trading price of our common stock.

***We may incur significant stock-based compensation charges related to certain stock options and restricted stock in future periods.***

Based on accounting standards involving stock compensation, we have incurred and will continue to incur non-cash accounting charges related to stock options, including those associated with our cancellation/regrant programs. Those standards require us to remeasure compensation costs for such options each reporting period based on changes in the market value of the underlying common stock. Depending upon movements in the market value of our common stock, the variable accounting treatment of those stock options may result in significant additional non-cash compensation costs in future periods.

In addition, the FASB issued in December 2004 SFAS No. 123R, *Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95*, that addresses the accounting treatment for employee stock options and other share-based payment transactions. The statement eliminates the ability to account for share-based compensation transactions using Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and generally requires that such transactions be accounted for using a fair-value-based method and recognized as expenses. The statement and the change in accounting treatment could result in our reporting increased operating expenses beginning for our next fiscal year after June 15, 2005, which would decrease any reported net income or increase any reported net loss, and could adversely affect the market price of our common stock.

***We are dependent on our international operations for a significant portion of our revenue.***

3% Convertible Senior Notes. During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of

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International revenue, primarily from customers based in Japan and Europe, accounted for 32% of our revenue for the three and nine months ended April 30, 2005, and 30% and 34% for the corresponding periods in fiscal 2004, respectively. In the future, we may further expand our international presence. As we continue to expand internationally, we are increasingly subject to risks of doing business internationally, including:

longer payment cycles and problems in collecting accounts receivable;

seasonal reductions in business activity during the summer months in Europe and certain other parts of the world;

unexpected changes in regulatory requirements and tariffs;

export controls relating to encryption technology and other export restrictions;

reduced protection for intellectual property rights in some countries;

fluctuations in currency exchange rates, against which we do not currently hedge;

difficulties in staffing and managing international operations; and

an adverse effect on our provision for income taxes based on the amount and mix of income from international customers.

Our international sales growth will be limited if we, in the future, are unable to expand international sales channel management and support, customize products for local markets, and develop relationships with international service providers, distributors and device manufacturers. For example, in recent quarters we have invested substantially in expanding sales operations, and these investments may not generate offsetting increases in revenue. Even if we are able to expand international operations successfully, we cannot be certain that we will succeed in maintaining or expanding international market demand for our products.

***Geographic expansion and growth, including the establishment of new sales or engineering operations, may negatively affect our overall operations and cause us to incur significant additional costs and expenses.***

We established engineering facilities in Sofia, Bulgaria and Cluj-Napoca, Romania and, in the future, we may further expand our engineering or sales operations to other geographic areas within the United States and internationally. Our expansion may cause us to incur various costs and expenses, and may place a significant strain upon our operating and financial systems and resources that could materially adversely affect our financial results following such an expansion. We also face significant business risks related to the difficulty in assimilating new operations and the diversion of management's attention from other business. Additionally, if we fail to align employee skills and populations with revenue and market requirements, it may have a material adverse impact on our business and operating results. Moreover, these newly established operations may not contribute significantly to our sales or earnings.

3% Convertible Senior Notes. During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of

*Foreign exchange fluctuations could decrease our revenue or cause us to lose money, especially since we do not hedge against currency fluctuations.*

We believe that in the future, an increasing portion of our costs will be denominated in foreign currencies as we increase operations in Europe and open offices in other countries. We currently do not engage in foreign exchange hedging activities and, although we have not yet experienced any material losses due to foreign currency fluctuation, a small portion of our international revenue are currently subject to the risks of foreign currency fluctuations, and these risks will increase as our international revenue increases.

*Our recent and any potential acquisitions could require significant management attention and prove difficult to integrate with our business, which could distract our management, disrupt our business, dilute stockholder value and adversely affect our operating results.*

As part of our strategy, we intend to continue to make investments in complementary companies, products or technologies. We recently acquired Tourmaline Networks, Inc. (in March 2005), SoftVision SRL's workforce (through a transfer in June 2004), Search Software America (in March 2004), Synchrologic, Inc. (in December 2003) and Spontaneous Technology, Inc. (in September 2003). We may not realize future benefits from any of these acquisitions, or from any acquisition we may make in the future. If we fail to integrate successfully our past and

future acquisitions, or the technologies associated with such acquisitions, into our company, the revenue and operating results of the combined company could be adversely affected. Any integration process will require significant time and resources, and we may not be able to manage the process successfully. If our customers are uncertain about our ability to operate on a combined basis, they could delay or cancel orders for our products. We may not successfully evaluate or utilize the acquired technology and accurately forecast the financial impact of an acquisition transaction, including accounting charges.

Acquisitions involve a number of additional difficulties and risks to our business, including, but not limited to, the following:

failure to integrate management information systems, personnel, research and development and marketing, sales and support operations;

potential loss of key employees from Intellisync or the acquired company;

disruption of our ongoing business;

potential loss of the acquired company's customers;

failure to develop further the acquired company's technology successfully, resulting in the potential impairment of amounts capitalized as intangible assets;

unanticipated costs and liabilities, including those that may arise from disputes over the earnout provision of the acquisition agreement;

amortization expenses related to intangible assets (other than goodwill); and

impairment charges under SFAS No. 142, *Goodwill and Other Intangible Assets* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

Further, we have issued common stock and paid cash for recent acquisitions and may have to pay cash, incur debt or issue equity securities to pay for any future acquisition, each of which could affect our financial condition or the market price of our common stock. The sale of additional equity or debt to finance such future acquisitions could result in dilution to our stockholders. The incurrence of indebtedness would result in increased fixed obligations and could also include covenants or other restrictions that would impede our ability to manage our operations.

3% Convertible Senior Notes. During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of



*Goodwill and other intangibles resulting from our acquisitions could become impaired.*

As of April 30, 2005, our goodwill, developed and core technology and other intangibles amounted to \$93,412,000, net of accumulated amortization. We ceased to amortize our existing goodwill upon our adoption of SFAS No. 142 in the beginning of fiscal 2003. We will amortize approximately \$2,239,000 for the three months ended July 31, 2005, and \$8,238,000, \$7,457,000, \$3,839,000, \$1,640,000 and \$2,463,000 for fiscal 2006, 2007, 2008, 2009 and thereafter, respectively, of developed and core technology and other intangibles. We expect, however, that amortization expense may increase significantly as a result of any future acquisitions. To the extent we do not generate sufficient cash flows to recover the net amount of any investment in goodwill and other intangibles recorded, the investment could be considered impaired and subject to write-off. We expect to record further goodwill and other intangible assets as a result of any future acquisitions we may complete. Future amortization of such other intangible assets or impairments, if any, of goodwill would adversely affect our results of operations in any given period.

***We depend on key employees in a competitive market for skilled personnel.***

The success of our business will continue to depend upon certain key technical and senior management personnel, including our president and chief executive officer, Woodson Hobbs; chief operating officer, Clyde Foster; chief marketing officer, Robert Gerber; chief strategy officer, Steven Goldberg; chief financial officer, J. Keith Kitchen; and chief technology officer, Said Mohammadioun, many of whom would be extremely difficult to replace. Competition for such personnel is intense, and we cannot be certain that we will be able to retain our existing key managerial, technical, or sales and marketing personnel. The loss of these officers and other or key employees in the future might adversely affect our business and impede the achievement of our business objectives. We believe our ability to achieve increased revenue and to develop successful new products and product enhancements will depend in part upon our ability to attract and retain highly skilled sales and marketing and qualified product development personnel. In addition, competition for employees in our industry and geographic location could be intense. We may not be able to continue to attract and retain skilled and experienced personnel on acceptable terms. Our ability to hire and retain such personnel will depend in part upon our ability to raise capital or achieve increased revenue levels to fund the costs associated with such personnel. Failure to attract and retain key personnel will adversely affect our business.

***Our revenue from consumer sales is subject to risks associated with the declining wired PDA market and reliance on sales distribution channels.***

While the market for converged mobile devices or smartphones and other wireless mobile devices has experienced growth recently, the market for traditional personal digital assistants, or PDAs, has declined. In addition, Sony Corporation recently announced its departure from the worldwide PDA market, dropping development of its CLIE product line. The decline in traditional PDA sales had a direct impact on sales of our Intellisync products through the consumer and online channels, where sales of our synchronization software typically occur at the same time a PDA is purchased, or shortly thereafter. The increase in demand for smartphones and other such devices may not offset the decline in traditional PDA sales. Our consumer sales are also dependent upon distribution and marketing channels outside our control. There are also a significant number of our customers that purchase our products and services through other resellers, and we anticipate they will continue to do so as we expand our product offerings. Our sales, therefore, could also be negatively affected by disruptions in our relationships with resellers or disruptions in the relationships between our resellers and customers. Resellers may also choose not to emphasize our products to their customers. If we are unable to offset declining revenue from PDA-related software, or if we experience disruption in, or reduced selling efforts from, our distribution channels, our revenue derived from consumer sales would be adversely affected.

***If we are unable to provide satisfactory and high quality services through our professional services group, customer satisfaction and demand for our products will suffer.***

Many of our customers have been successful in implementing our various technology initiatives without further provision of technical service. However, we believe that building strong relationships with our customers, as well as future growth in our product sales, depends on our ability to provide our customers with professional services, including customer support, training, consulting and initial implementation and deployment of our products when necessary. We have an in-house professional services group and use international software development partners with a workforce that can perform these tasks and that also educates third-party systems integrators in the use of our products so that these systems integrators can provide these services to our customers. If we are unable to develop sufficient relationships with third-party systems integrators and other customers, unable to complete product implementations in a timely manner, or unable to provide customers with satisfactory and quality support, consulting, maintenance and other services, we could face customer dissatisfaction, damage to our reputation, decreased overall demand for our products and loss of revenue.

***We may have to spend substantial funds on sales and marketing in the future.***

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To increase awareness for our new and existing products, technology and services, we may have to spend significantly more on sales and marketing in the future. We also plan to continue to leverage our relationships with industry leaders and to expand and diversify our sales and marketing initiatives to increase our sales to mobile carriers and enterprises. If our marketing strategy is unsuccessful, we may not be able to recover these expenses or even generate any revenue. We will be required to develop a marketing and sales campaign that will effectively

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demonstrate the advantages of our products, technology and services. We may also elect to enter into agreements or relationships with third parties regarding the promotion or marketing of our products, technology and services. We cannot be certain that we will be able to establish adequate sales and marketing capabilities, that we will be able to enter into marketing agreements or relationships with third parties on financially acceptable terms, or that any third parties with whom we enter into such arrangements will be successful in marketing and promoting the products, technology and services offered by us.

***Our products may contain errors that could subject us to product-related claims.***

Our products may contain undetected errors or failures, which can result in loss of or delay in market acceptance and could adversely impact future operating results. Our insurance may not cover us for certain claims related to product failures. Although our license agreements contain provisions limiting our liability in the case of damages resulting from use of the software, in the event of such damages, we may be found liable, and in such event, such damages could materially affect our business, operating results and financial condition.

***We may need to raise additional capital in the future resulting in dilution to our stockholders.***

We may need to raise additional funds for our business operations and to execute our business strategy. We may seek to sell additional equity or debt securities or to obtain an additional credit facility. The sale of additional equity or convertible debt securities could result in additional dilution to our stockholders. If additional funds are raised through the issuance of debt securities, these securities could have rights that are senior to holders of common stock and could contain covenants that would restrict our operations. Any additional financing may not be available in amounts or on terms acceptable to us, if at all.

***We may not have sufficient cash flow to make payments on any debt we may incur.***

Our ability to pay principal and interest on our existing and any future indebtedness and to fund our planned capital expenditures depends on our future operating performance. Our future operating performance is subject to a number of risks and uncertainties that are often beyond our control, including general economic conditions and financial, competitive and regulatory factors. Consequently, we cannot assure you that we will have sufficient cash flow to meet our liquidity needs, including making payments on existing and any future indebtedness.

***The fundamental change redemption rights in our outstanding convertible senior notes could discourage a potential acquirer.***

If we engage in any transaction or event in connection with which all or substantially all of our common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive, consideration which is not all or substantially all common stock listed on a United States national securities exchange or approved for quotation on the Nasdaq National Market or any similar United States system of automated dissemination of quotations of securities prices, or, if for any reason, our common stock is no longer listed for trading on a United States national securities exchange nor approved for trading on the Nasdaq National Market (a fundamental change), we may be required to redeem all or part of the notes and this could discourage a potential acquirer. However, this redemption feature is not the result of management's knowledge of any specific effort to obtain control of us by means of a merger, tender offer or solicitation, or part of a plan by management to adopt a series of anti-takeover provisions. The term fundamental change is limited to specified transactions and may not include other events that might adversely affect our financial condition or business operations. Our obligation to offer to redeem the notes upon a fundamental change would not

3% Convertible Senior Notes. During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of

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necessarily afford you protection in the event of a highly leveraged transaction, reorganization, merger or similar transaction involving us.

*We may not have the ability to raise the funds necessary to finance the fundamental change redemption option associated with our outstanding convertible senior notes.*

If we engage in any transaction or event in connection with which all or substantially all of our common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive consideration which is not all or substantially all common stock listed on a United States national securities exchange or approved for quotation on

the Nasdaq National Market or any similar United States system of automated dissemination of quotations of securities prices, or, if for any reason, our common stock is no longer listed for trading on a United States national securities exchange nor approved for trading on the Nasdaq National Market, we may be required to redeem all or part of the notes. We may not have enough funds to pay the redemption price for all tendered notes. In addition, any credit agreement or other agreements relating to our indebtedness may contain provisions prohibiting redemption of the notes under certain circumstances, or expressly prohibit our redemption of the notes upon a designated event or may provide that a designated event constitutes an event of default under that agreement. Our failure to redeem tendered notes would constitute an event of default under the indenture, which might also constitute a default under the terms of our other indebtedness.

*Our certificate of incorporation, our bylaws, Delaware law and our stockholder rights plan contain provisions that could discourage a takeover.*

Provisions of our certificate of incorporation, our bylaws, Delaware law and our stockholder rights plan contain provisions that may discourage, delay or prevent a merger or acquisition or other change of control that a stockholder may consider favorable.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to a variety of risks, including changes in interest rates and foreign currency fluctuations, which could impact our results of operations and financial condition.

*Interest Rate Risk*

At April 30, 2005, we had an investment portfolio of mostly fixed income securities, including those classified as cash equivalents and securities available-for-sale, of \$36,308,000. These securities, like all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels as of April 30, 2005, the decline of the fair value of the portfolio would be immaterial. We attempt to mitigate risk by holding our fixed income investments until maturity to avoid recognizing an adverse impact in income or cash flows in the event of an increase in market interest rates, but an increase in our liquidity needs may require us to sell fixed-rate securities prior to maturity.

The table below presents the carrying value (which approximates fair value) and related weighted average coupon interest rates for our investment portfolio at April 30, 2005 (in thousands, except interest rates).

	Carrying Amount	Average Coupon Interest Rate
Cash equivalents	\$ 13,073	2.7%
Securities with maturity:		
Due within one year or less	12,874	2.6%
Due after one year through two years	740	2.4%
Auction rate receipts due after 25 years through 40 years	3,700	2.9%
Annuities, auction rate preferred stock and other, with no maturity	5,921	3.0%
Total portfolio	\$ 36,308	2.8%

*Debt and Interest Expense.* We incurred \$60,000,000 of principal indebtedness from the issuance of convertible senior notes in March 2004. The fair market value of these 3% convertible senior notes is sensitive to changes in interest rates and to the prices of our common stock into which it can be converted as well as our financial stability. In order to manage interest costs and risk, we entered into an interest rate swap agreement during fiscal 2004 with a financial institution on a total notional amount of \$50,000,000 and \$10,000,000, whereby we receive fixed-rate interest of 3% in exchange for variable interest payments. The interest rate swaps expire upon the maturity of our \$60,000,000, 3% convertible senior notes in March 2009, and effectively converts those fixed-rate notes into variable-rate borrowings. The interest rate is reset semi-annually and is equal to the 6-month LIBOR rate less a rate spread. The total variable interest rate, approximately 2.9% at April 30, 2005, resulted in interest expense savings relative to fixed rates of approximately \$486,000 for the first three quarters of fiscal 2005. Under the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, this arrangement has been designated and qualifies as an effective fair value hedge of interest rate risk related to the \$60,000,000 convertible senior notes. As the terms of the swaps match those of the underlying hedged debt, the changes in the fair value of these swaps are offset by corresponding changes in the carrying value of the hedged debt, and therefore does not impact our net earnings. As of

3% Convertible Senior Notes. During the third quarter of fiscal 2004, we completed the offering of \$60,000,000 of

April 30, 2005, the fair value of the interest rate swaps was approximately \$2,116,000 with an equal adjustment recorded to the carrying value of the \$60,000,000 convertible senior notes. Assuming a one percentage point increase in the prevailing LIBOR rate, holding other terms of the swap constant, the fair value of the interest rate swap and the underlying senior notes would change by approximately \$1,980,000.

*Foreign Currency Risk*

With our acquisitions of Synchronologic and Identity Systems in fiscal 2004, more of our product and service revenue has been derived from international markets and denominated in the currency of the applicable market. As we increasingly pursue business opportunities in foreign countries, our foreign revenue and operating results may



become subject to significant currency fluctuations based upon changes in exchange rates of certain currencies in relation to the United States dollar.

We are also exposed to foreign currency exchange rate fluctuations as the financial statements of foreign subsidiaries are translated into United States dollar in consolidation. As exchange rates vary, these results, when translated, may vary from expectations and adversely impact overall expected profitability. Assets and liabilities of most of our subsidiaries are translated into U.S. dollars at exchange rates in effect as of the applicable balance sheet date and any resulting translation adjustments are included as an adjustment to stockholders' equity. Revenue and expenses generated from these subsidiaries are translated at average monthly exchange rates during the quarter the transactions occur. Gains and losses from these currency transactions are included in net earnings. Recently, we have increasingly generated a portion of our revenue and incurred a portion of our expenses in euros, British pounds, the Japanese yen and Australian dollars.

We currently do not have any hedging or similar foreign currency contracts to mitigate our exposure to the risk of changes in foreign currency rates. Although we may begin to hedge in the future, we cannot be sure that any hedging techniques we may implement will be successful or that our business, results of operations, financial condition or cash flows will not be adversely affected by exchange rate fluctuations.

We may continue to expand internationally in the future and become increasingly subject to other risks of doing business internationally including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, and other regulations and restrictions. We will also be exposed to increased risk of non-payment by our customers in foreign countries, especially those of highly inflationary economies. Accordingly, our future results could be materially adversely impacted by changes in these and other factors. Furthermore, to the extent that we engage in international sales denominated in United States dollars, an increase in the value of the United States dollar relative to foreign currencies could make our products and services less competitive in international markets.

#### **Item 4. Controls And Procedures**



*Evaluation of disclosure controls and procedures*

Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our 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)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

*Changes in internal control over financial reporting*

We generate a significant portion of our revenue in remote sales offices throughout the world, where we transact business in multiple languages and often employ personnel that are not as familiar with U.S. GAAP as are our personnel in the United States. In the third quarter of fiscal 2005, we began the process of centralizing a number of significant internal controls and extending headquarters-based enterprise accounting and revenue systems to certain of our remote offices. These changes are designed to establish consistent information systems and internal controls throughout the company and ensure a centralized review in the United States of significant contracts from foreign jurisdictions.

There were no other changes in our internal control over financial reporting during the third quarter of fiscal 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**INTELLISYNC CORPORATION**

**PART II - OTHER INFORMATION**

**Item 1. Legal proceedings**

There were no updates or developments during the three months ended April 30, 2005 on any pending legal proceedings, including the patent-infringement claim filed against us by NCR Corporation, to which we, or any of our subsidiaries, are a party. For additional discussion of our pending legal proceedings, see our Annual Report on Form 10-K for the period ended July 31, 2004 and the Quarterly Reports on Form 10-Q for the period ended October 31, 2004 and January 31, 2005.

**Item 2. Changes in securities and use of proceeds** Not Applicable.

**Item 3. Defaults upon senior securities** Not Applicable.

**Item 4. Submission of matters to a vote of security holders** Not Applicable.

**Item 5. Other information** Not Applicable.

**Item 6. Exhibits**

**(a) Exhibits**

- 3.1 Amended and Restated Bylaws of Pumatech, Inc., a Delaware corporation (Incorporated herein by reference to Registrant's Annual Report on Form 10-K for fiscal year ended July 31, 2002, filed on October 17, 2002, Commission File No. 000-21709).
- 3.2 Charter for the Audit Committee of the Board of Directors (Incorporated herein by reference to Registrant's joint proxy statement/prospectus on Form S-4/A, filed on November 26, 2003, Registration No. 333-109881).
- 10.1 Master Software License, Software Development Agreement, Maintenance and Services Agreement and Reseller Agreement dated July 2, 2004 by and between Intellisync Corporation and Cellco Partnership d/b/a Verizon Wireless (Certain portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission) (Incorporated herein by reference to Registrant's Annual Report on Form 10-K for fiscal year ended

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July 31, 2004, filed on October 14, 2004, Commission File No. 000-21709).

- 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 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32.2 Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
-

**SIGNATURE**

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 hereunto duly authorized.

**INTELLISYNC CORPORATION**  
(Registrant)

Date: June 9, 2005

By: */s/ J. KEITH KITCHEN*  
**J. Keith Kitchen**  
*Chief Financial Officer*  
(Principal Financial and Accounting Officer)

**EXHIBIT INDEX**

**Exhibit No.**

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