

SOCKET COMMUNICATIONS INC  
Form 10-K  
March 07, 2008

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
**FORM 10-K**

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

**For the fiscal year ended December 31, 2007**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission file number 1-13810**

**SOCKET COMMUNICATIONS, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**94-3155066**

(IRS Employer Identification No.)

**39700 Eureka Drive, Newark, CA 94560**

(Address of principal executive offices including zip code)

**(510) 933-3000**

(Registrant's telephone number, including area code)

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

Title of Each Class	Name of Exchange on Which Registered
Common Stock, \$0.001 Par Value per Share	The NASDAQ Stock Market LLC

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

None

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

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

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

## Edgar Filing: SOCKET COMMUNICATIONS INC - Form 10-K

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

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

As of June 29, 2007, the aggregate market value of the registrant's common stock (\$0.001 par value) held by non-affiliates of the registrant was \$26,192,196 based on the closing sale price as reported on the National Association of Securities Dealers Automated Quotation Global Market System.

Number of shares of common stock (\$0.001 par value) outstanding as of February 29, 2008: 32,015,975 shares

### DOCUMENTS INCORPORATED BY REFERENCE

Items 10, 11, 12, 13, and 14 of Part III are incorporated by reference from the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on April 23, 2008. Such Proxy Statement will be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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### TABLE OF CONTENTS

#### PART I

Item 1.	<u>Business</u>	1
Item 1A.	<u>Risk Factors</u>	15
Item 1B.	<u>Unresolved Staff Comments</u>	25
Item 2.	<u>Properties</u>	25
Item 3.	<u>Legal Proceedings</u>	25
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>	25

#### PART II

Item 5.	<u>Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities</u>	26
Item 6.	<u>Selected Consolidated Financial Data</u>	28
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	43

Item 8.	<u>Financial Statements and Supplementary Data</u>	44
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	68
Item 9A(T).	<u>Controls and Procedures</u>	68
Item 9B.	<u>Other Information</u>	69
<b>PART III</b>		
Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	69
Item 11.	<u>Executive Compensation</u>	69
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	69
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	70
Item 14.	<u>Principal Accounting Fees and Services</u>	70
<b>PART IV</b>		
Item 15.	<u>Exhibits and Financial Statement Schedules</u>	70
<b><u>SIGNATURES</u></b>		71
		&nbsp;
<b><u>Index to Exhibits</u></b>		72

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## PART I

*This Annual Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include statements forecasting future financial results and operating activities, market acceptance of our products, expectations for general market growth of handheld computers and other mobile computing devices, growth in demand for our products, expansion of the markets that we serve, expansion of the distribution channels for our products, adoption of our embedded products by third-party manufacturers of electronic devices, and the timing of the introduction and availability of new products, as well as other forecasts discussed under "Management's Discussion and Analysis of Financial Condition and Results of Operations." Words such as "may," "will," "predicts," "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," variations of such words, and similar expressions are intended to identify such forward-looking statements. Such forward-looking statements are based on current expectations, estimates, and projections about our industry, management's beliefs, and assumptions made by management. These forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties, and assumptions that are difficult to predict; therefore, actual results and outcomes may differ materially from what is expressed or forecasted in any such forward looking statements. Factors that could cause actual results and outcomes to differ materially include, but are not limited to: the risk of delays in the availability of our products due to technological, market or financial factors including the availability of necessary working capital; our ability to successfully develop, introduce and market future products; our ability to effectively manage and*

*contain our operating costs; the availability of announced third-party handheld computer hardware and software that our products are intended to work with; product delays associated with new model introductions and product changeovers by the makers of products that our products are intended to work with; continued growth in demand for handheld computers; market acceptance of emerging standards such as Bluetooth and Wireless LAN and of our related connection, data collection and mobile handheld computer products; the ability of our strategic relationships to benefit our business as expected; our ability to enter into additional distribution relationships; or other factors described in this Form 10-K including "Item 1A. Risk Factors" and recent Form 8-K and Form 10-Q reports filed with the Securities and Exchange Commission. We assume no obligation to update such forward-looking statements or to update the reasons why actual results could differ materially from those anticipated in such forward-looking statements.*

*You should read the following discussion in conjunction with the consolidated financial statements and notes included elsewhere in this report, and other information contained in other reports and documents filed from time to time with the Securities and Exchange Commission.*

## **Item 1. Business**

### **The Company**

We are a producer of mobile systems serving the business market. Mobile systems solutions typically consist of a handheld computer, data collection and connectivity peripherals, and third-party vertical applications software. We have historically offered a wide range of data collection and connectivity peripheral products and embedded products for use with mobile computing devices offered by third-parties. Commencing in June 2007, we introduced our own mobile handheld computer and began offering mobile systems for use with third-party vertical applications software.

### (Table of Contents)

See "Products" for a description of the products that we offer or plan to offer. We work with more than 100 software integration companies that are offering or developing vertical application software for use with handheld computers. Examples of these vertical applications include patient medication administration within the health care industry, retail merchandising such as managing inventory on retail store shelves, sales and field force automation involving the collection and processing of orders or service information from remote locations by sales and service personnel, asset management and inventory control for assets having bar codes or radio frequency identification tags, and mobile point of sale applications. These mobile solutions are designed to improve the productivity of business enterprises by automating manual tasks, improving the quality of information collected, and enhancing mobile productivity by processing and transferring information from remote locations and mobile devices to the business enterprise, and then if required, back to the remote locations and mobile devices.

We believe that growth in the mobile workforce, technical advances and cost reductions in mobile devices and networking technologies, and the pervasive use of the Internet are driving broader adoption of mobile data communications. Our products are designed to address the growing need for mobile workforce connectivity by enabling the use of handheld computers to extend data communications capabilities beyond location-dependent wired networks or telephone lines, thereby enabling handheld computer users to enhance their productivity, exploit time sensitive opportunities and improve customer satisfaction. Overall, our products enable the integration of hardware, software and applications into complete mobile data collection and connectivity solutions.

Total employee headcount on December 31, 2007 was 81 people. We subcontract the manufacturing of substantially all of our products to independent third-party contract manufacturers who are located in the U.S., China and Taiwan and who have the equipment, know-how and capacity to manufacture products to our specifications. We market our products through a worldwide network of distributors and resellers, as well as through original equipment manufacturers (OEMs), vertical industry partners, and value added resellers (VARs). See "Personnel," "Sales and Marketing," and "Manufacturing" for additional information about our personnel, sales and marketing and manufacturing operations.

We have financed our operations since inception primarily from the sale of equity capital and have no material long term debt. We also have a receivables-based working capital line of credit with a bank that we use for additional cash resources, and we typically draw on this line of credit at the end of each quarter. Our data collection, connectivity, serial, and mobile handheld computer products are offered as standard products through general distribution channels and can be supplied within a few weeks of being ordered, so we do not have a large order backlog. Our order backlog at December 31, 2007 was \$1.4 million.

Socket Communications, Inc. was founded in March 1992 and reincorporated in Delaware in 1995. We began doing business as Socket Mobile, Inc. in January 2007 to better reflect our market focus on the mobile business market. Our Board of Directors is recommending to our stockholders a permanent name change to Socket Mobile, Inc. for approval at the Annual Meeting of Stockholders in April 2008. Our common stock trades on the NASDAQ Global Market under the symbol "SCKT". Our principal executive offices are located at 39700 Eureka Drive, Newark, CA 94560, and our phone number is (510) 933-3000. Our Internet home page is located at <http://www.socketmobile.com>; however, the information on, or that can be accessed through, our home page, is not part of this Annual Report. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to such reports are available free of charge on or through our Internet home page, as soon as reasonably practical after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC).

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(Table of Contents)

**Products**

Our products may be classified into four broad product families:

- Mobile handheld computer products;
- Mobile peripheral products:
  - Data collection products,
  - Connectivity products;
- OEM embedded products; and
- Serial interface products.

Our *mobile handheld computer products* have been designed to address the business mobility market for a handheld computer that is neither a consumer-oriented handheld device nor a heavy duty industrial device. Our initial model, the SoMo 650 (SoMo is derived from Socket Mobile), introduced in June 2007, features the Microsoft Windows Mobile 5.0 Professional operating system to ensure a high level of mobile application compatibility and to give workers a familiar computing environment. Our mobile handheld computer is easy to customize and integrate with peripherals and information systems and has an expected product life cycle of three to five years which meets the needs of businesses for longer deployments than have been available with most consumer-oriented handheld devices. Our mobile handheld computer's features include Wireless LAN and Bluetooth, a fast processor, a large, bright screen display, large amounts of SDRAM and flash memory, extended battery life, programmable action buttons to activate

peripheral devices, reinforced CompactFlash and SDIO card slots, and a durable case. Additional models are in development that will run the Windows Mobile 6.0 operating system, add multiple language support, enable extended outdoor use, and offer specialized versions oriented to the needs of specific vertical markets. The SoMo 650 was specifically designed without an integrated mobile phone as most solutions involving our products use Bluetooth or Wireless LAN connections for data communications and do not require an integrated mobile phone. Mobile handheld computer products represented approximately 6 percent of our revenue for the year ended December 31, 2007.

Our mobile peripheral products consist of data collection products and connectivity products, which together represented approximately 60 percent, 58 percent, and 60 percent of our revenues for the years ended December 31, 2007, 2006, and 2005, respectively.

Our *data collection products* enable the electronic collection of data from bar codes, radio frequency identification tags, or magnetic stripes and consist of:

- bar code scanning products that plug into or connect wirelessly to handheld computers, tablet computers, notebook computers and smartphones that use Windows Mobile, Windows XP, Windows Tablet, J2ME, or Symbian 60 or Symbian 80 operating systems, and turn these devices into portable bar code scanners that can be used in various retail and industrial workplaces;
- radio frequency identification plug-in products that read radio frequency identification tags;
- a combination plug-in bar code scanner and radio frequency identification reader; and
- a plug-in magnetic stripe reader.

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(Table of Contents)

We have developed extensive bar code scanning software called SocketScan that supports all of our data collection products, and have software developer kits that assist third-party developers in integrating our SocketScan software and our hardware products into their applications and solutions. Our bar code scanning products include CompactFlash and SDIO plug-in bar code scanners for linear and two-dimensional bar code scanning, along with a cordless handheld bar code scanner and a ring scanner worn on the index finger, both of which connect to computing systems using the Bluetooth standard for short-range wireless connectivity. Data collection products represented approximately 50 percent, 42 percent, and 39 percent of our revenue for the years ended December 31, 2007, 2006, and 2005, respectively.

Our *connectivity products* are connection devices that can be plugged into standard expansion slots in handheld computers, tablet computers, and notebook computers that use Windows Mobile, Windows XP, or Windows Tablet operating systems. These products allow users to connect their devices via Ethernet or telephone to communicate with other networks and devices such as desktop computers, other handheld, tablet and notebook computers, smartphones and printers. Our connectivity products include:

- modems for telephone connections that connect over a cable, and a cordless modem that utilizes Bluetooth wireless technology to connect a telephone to a Bluetooth-enabled computer or other device;
- ethernet cards for local area network connections that connect over a cable; and
- accessory products such as batteries and cables.

Connectivity products represented approximately 10 percent, 16 percent, and 22 percent of our revenue for the years ended December 31, 2007, 2006, and 2005, respectively.

Our *OEM embedded products* consist of Bluetooth and Wireless LAN modules and plug-in cards used primarily by OEMs of handheld computers and other devices to build wireless connection functions into their products using the Bluetooth and Wireless LAN standards for wireless connectivity. Our plug-in cards and modules using the Bluetooth standard for short-range wireless connectivity include extensive communications software enabling the use of these products. Our plug-in cards for connecting to local wireless networks using the Wireless LAN 802.11b/g (or Wi-Fi) standards include extensive communications software enabling the use of these products. We have recently added Cisco Compatible Extensions (CCX) 4.0 certification to our Wireless LAN software to enable our Wireless LAN products to be compatible with a Cisco wireless LAN infrastructure. Bluetooth and wireless LAN connection functions are being built into many third-party mobile devices, which may reduce the demand for our plug-in products through expansion slots but may increase the demand for our Bluetooth and Wireless LAN modules and embedded plug-in cards. OEM embedded products represented approximately 27 percent, 32 percent, and 27 percent of our revenue for the years ended December 31, 2007, 2006, and 2005, respectively.

### (Table of Contents)

Our *serial interface products* enable the connection of a mobile computer to electronic devices either as a plug-in card (one, two or four ports) connecting over cables, or wirelessly over a Bluetooth network. We have recently introduced a USB to serial connector to enable a serial connection through a USB interface. Serial interface products represented approximately 7 percent, 10 percent, and 13 percent of our revenue for the years ended December 31, 2007, 2006, and 2005, respectively.

We target business customers and markets with our products. Most of our products, except our embedded products, are sold through distributors and resellers that service businesses. Our OEM embedded products are sold directly to the manufacturers of products in which our products are embedded. The geographic regions we serve include the Americas, Europe, the Middle East, Africa and Asia Pacific.

### **Market Dynamics**

Handheld computers have evolved over the past several years from simple devices used mainly to hold personal information into small portable units with functionality similar to desktop PCs. Many handheld computers, such as the Pocket PC (including our SoMo line of mobile handheld computers) and Palm Treo, have built-in expansion capabilities in standard form factors, typically CompactFlash, Secure Digital Input/Output or Bluetooth, to allow for transfer of data in and out of the handheld computer over wireless or wired connections. Many handheld computers, such as the Palm Treo, Research-In-Motion's Blackberry and Windows Mobile handheld computer phone editions, often referred to as smartphones, also include an integrated phone to enable voice communications over mobile phone networks, and broadband radios for data communications. Notebooks and tablet computers also have expansion capabilities to enable their use in mobile environments, as well as broadband radios for data communications.

Advances in mobile network access and transfer speeds are enabling mobile computing device users to access the Internet, send and receive email including attachments, access corporate data files, and to transfer data directly to and from other mobile devices using Bluetooth wireless technology or cables for short distances, wireless local area networks, or broadband radios with increased speed and bandwidth. Our connectivity products and technologies (wireless LAN, Bluetooth and serial interface products) are designed to easily add these technologies to mobile devices. In addition, mobile devices with standard expansion capabilities are effective at collecting data. Our data collection products are designed to facilitate the collection of bar code, radio frequency identification, and magnetic stripe information on these devices by plugging into the standard expansion slots of these data collection devices or connecting wirelessly.

Handheld computers have traditionally been classified into consumer and industrial. Consumer devices such as those offered by Hewlett-Packard are designed for personal use and fit in a pocket or purse. Industrial devices such as those offered by Motorola are designed for rugged environments such as outdoors or warehouses and are much larger, heavier and more expensive. Businesses have had to choose from these two categories in designing mobile solutions, and we believe neither solution is an ideal fit for many business needs. Our first mobile handheld computer model introduced in June 2007 is a standard Windows Mobile OS based handheld device without telephony technology and is designed specifically to address essential business requirements to improve mobile worker productivity. Compared to consumer devices, it is similar in size and weight but is more durable, has programmable buttons to activate functions such as SocketScan, our data collection software, adds features such as seamless roaming to improve the worker experience in using wireless LAN, incorporates Socket's Connect!Agent to improve the user experience with short range cordless Bluetooth technology, has fast processors, large memory and extended battery life. Compared to industrial devices, it is smaller in size and weight, less rugged, and less expensive. We plan to introduce additional models to provide more choices to businesses that are deploying mobile computing solutions.

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(Table of Contents)

Growth in the mobile workforce and increasing reliance on the Internet and on access to corporate databases and email are increasing the demand for mobile data communications. The capability of a mobile workforce to collect data in the field and to transfer it electronically generally improves the timeliness and accuracy of information such as order entry, process management or transaction reporting. Advances in connection technologies, local area networking and wide area networking are being commercialized to allow handheld computers to interact with nearby computers and with a wide array of electronic appliances, including mobile phones, printers, digital cameras, local area network access points, Global Positioning System receivers, automobile communications systems, bar code scanners, radio frequency identification tags, home entertainment and security systems, public kiosks, public Internet access locations and vending machines.

Current market dynamics driving the adoption of mobile data communications by enterprises include:

*Functionality of today's mobile computing devices is extensive and improving.* Unlike early models, most mobile computing devices now offer bright outdoor color screens and longer battery life, have software allowing their use as business messaging devices with capacity to store personal information, and have standard expansion capabilities or use Bluetooth or wireless local or wide area network connections to transfer data in and out of the device. Popular desktop programs such as Word and Excel are available for today's handheld, tablet and notebook computers, enabling users to send and receive emails with full attachments, run popular personal information management and business programs, run entertainment and education software for games, music or books, view and interact with the Internet with enhanced and feature-rich graphics, have direct access to corporate data files (subject to business security arrangements), and use instant messaging over mobile networks. Mobile devices also can become lightweight mobile bar code, radio frequency identification, and magnetic stripe scanning devices when used with our bar code scanning, radio frequency identification, or magnetic stripe reader products, enabling the capture and processing of bar code, radio frequency identification, or magnetic stripe information (such as credit or identification cards) in a mobile environment.

*The mobile workforce is growing and is increasingly reliant on email and the Internet.* The worldwide mobile workforce has been estimated at more than 20 percent of the global workforce. Before advancements in handheld computers and wireless networks over mobile phones and through wireless local area network access points, the mobile workforce had been unable to effectively stay connected with email, the Internet or corporate data except through telephone lines. With the growth in the use of the Internet and email for business and personal applications,



workers and consumers are increasingly dependent on access to the Internet and email for managing their business and personal lives. Recent improvements in wireless LAN and mobile phone connectivity for dial-up networking, and deployment of mobile computers by corporations to their mobile workforce are expected to be major factors driving growth in mobile data applications over the next several years.

(Table of Contents)

*Third-party applications for enterprises are becoming available in increasing numbers.* Third-party software applications are becoming increasingly available for the collection, processing and transfer of information by a mobile workforce. Mobile computing devices are being used for such diverse applications as checking patient medications when administering them in a hospital, capturing lot numbers of drug samples given to a doctor, managing the stocking of shelves in retail establishments, or entering sales orders from the field. Larger enterprise software companies such as Oracle Corporation have written applications for Windows Mobile devices that use our bar code scanning products. SAP has enabled our SDIO form factor scanning card in all mobile applications developed by SAP and by other vendors that interface with SAP solutions through SAP's NetWeaver Mobile program. We have supported the development and deployment of our products in third-party applications through our Vertical Industry Partners Program and more than 100 companies are participants in this program. Our Vertical Industry Partners Program is described more fully under "Sales and Marketing." The availability of productivity-enhancing application software is a major driver of enterprise deployment of mobile computing devices.

**Marketing Strategy**

Our marketing strategy has been to capitalize on our strategic relationships, expand and improve our product offerings including software to enable wireless and wired connections designed to provide an easy-to-use experience and adding a family of mobile handheld computers to our product lines, build a strong brand name, support the development of third-party software applications and integrator solutions, and encourage device manufacturers to build our technology directly into their products. With the introduction of our mobile handheld computer, we offer a complete hardware solution consisting of a mobile handheld computer and peripherals which allows VARs and integrators to offer a one-stop solution in combination with their own or third-party vertical software applications for the mobile workforce.

*Capitalize on Strategic Relationships.* We support and encourage direct endorsements and referrals for our products from our strategic relationships, including operating system providers, device manufacturers, third-party software developers, vertical industry partners, distributors, and end-user customers. We actively promote third-parties to integrate our products into their solutions through our Vertical Industry Partners Program. We have a team of employees that manages each strategic relationship, and we provide software developer kits, training and technical support to our software and hardware developers. We coordinate our product development efforts with Microsoft on an ongoing basis, with the goal of ensuring that our current and future products are compatible with new releases of Microsoft's operating systems. We spend extensive engineering time and resources to ensure that our data collection peripheral products are compatible with a wide variety of handheld computers including Pocket PCs, the Palm Treo, the Blackberry from Research-In-Motion, and smartphones using the Symbian 60 and 80 operating system. Dell is a direct reseller of our products including our SoMo family of mobile computers. We work closely with the sales teams of Dell and Hewlett-Packard to assist them in offering mobile device solutions that include our products.

(Table of Contents)

*Expand and improve our product offerings.* We offer a wide range of data collection and connectivity peripheral products that are used with our SoMo family of mobile computers and other mobile devices, and we encourage our distributors to carry the full range of our products. The goal is for customers to view Socket as a single source for their connection needs, instead of having to rely on individual product offerings from a number of different companies. During the past three years, we have introduced a number of hardware and software products, including a 56K plug-in modem in SDIO form factor, a radio frequency identification reader, a combination radio frequency identification reader and laser bar code scanner, a cordless ring bar code scanner designed to be worn on the index finger for use in package handling, an 802.11g upgrade to our CompactFlash 802.11b wireless LAN card, and a wireless LAN module to add embedded Wireless LAN to our OEM product offerings. We continue to add features to our Bluetooth software for Windows notebooks and tablets, our wireless local area network software and SocketScan, our bar code scanning and radio frequency identification software. During 2006, we upgraded our products to comply with the Reduction of Hazardous Substances (RoHS) rules being implemented in Europe and around the world by changing the solder used in our products to be lead-free. We also qualify our products with the agencies responsible for ensuring that electronic products meet worldwide standards for safety and performance.

*Build a Stronger Brand Name.* We are building a brand image of "Increasing Mobile Productivity." This image emphasizes quality and standards-based connectivity. Our products are "Mobility Friendly," which means products that are compact and designed to be mobile, low power to extend time between charges, and easy to use. Our focus is to work with our partners to develop productivity enhancing solutions for the mobile workforce. In January 2007, we began doing business as Socket Mobile, Inc. to emphasize our commitment to mobile computing solutions. Our overall company brand identity and positioning goal is to become "the leading provider of easy-to-deploy business mobility systems and peripherals."

*Support the development of third-party software applications and integrator solutions.* We have created software developer kits for many of our products including bar code scanning, radio frequency identification, Bluetooth, and Wireless LAN. In addition, we have employees dedicated to assisting developers and integrators with integrating our products into their solutions. Our Vertical Industry Partners Program includes over 100 companies that offer or are developing software solutions which incorporate Socket products. These solutions primarily involve data collection and address improving the productivity of the mobile workforce in a number of businesses including health care, field force automation, asset management, retail merchandising, and automotive/transportation.

*Encourage device manufacturers to build our technology directly into their products.* To capture the OEM embedded connection business, we have built relationships with certain mobile device manufacturers and work with them to integrate our Bluetooth and Wireless LAN modules and value-add software into their own product designs. The majority of these manufacturers are building vertical application devices for special purpose markets. We have an internal team of employees that manages our OEM products business. We also provide developer support to our mobile device manufacturer customers to assist them as needed to integrate our embedded products into their mobile devices.

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(Table of Contents)

**Competition and Competitive Risks**

The overall market for data collection and connectivity products is both complex and competitive. Our products compete with similar products that are manufactured by companies in Asia and Europe. However, our longtime focus

on creating innovative data collection and connectivity solutions for the mobile workforce has resulted in good brand name recognition and reputation. We also believe that our brand name identifies our products as robust, dependable, small form factor, low power and easy to use, and the breadth of our product offerings, including the extensive features of our software, will continue to differentiate us relative to our competitors. The addition of a mobile handheld computer in 2007 enables us to better control the handheld computing environment for our peripheral products and allows us to offer one-stop shopping for the hardware portion of mobile business solutions. The competition in each of our product families is discussed in more detail below.

*Handheld computers.* Our first SoMo mobile handheld computer was introduced in June 2007 to address the price/performance market gap between consumer handheld computers and industrial handheld computers. Consumer-oriented handheld computers offer fewer features at a lower cost than industrial handheld computers. As described in Products - mobile handheld computer products, relative to a consumer-oriented handheld computer, our SoMo mobile handheld computer offers improved features beneficial in a business environment including increased durability, improved software features such as Wireless LAN roaming (staying connected between access points), and a combination of a fast processor, large memory, and multiple ways to access data including CompactFlash and Secure Digital plug-in slots and wireless LAN and Bluetooth technologies. The SoMo mobile handheld computer is less rugged than an industrial handheld computer but has many of the same features at a significantly reduced price point. We will continue to expand our family of SoMo mobile handheld computers to address the various needs of our enterprise customers. Consumer grade handheld computers are offered by Hewlett-Packard, Acer, Siemens and others. Industrial ruggedized grade of handheld computers are offered by Motorola, Intermec, and Honeywell. These companies have offered handheld computers for many years and have an established market presence. Their handheld computers are competitive alternatives to our mobile handheld computers, although we have differentiated our products for the markets that we have identified. In addition, in the past we have worked closely with handheld computer manufacturers to allow our peripheral products to work with their handheld computers, and we will continue to do so.

*Data Collection Products.* Our laser and CMOS imager bar code scanning products face competition from ruggedized integrated bar code scanning devices from Motorola, Intermec, Honeywell, Casio, Itronix and others. Many of these companies have been expanding their product lines to offer less expensive devices designed for enterprise use, which is narrowing the gap between the cost of consumer devices that use our peripheral data collection products and industrial devices. We purchase laser engines from Motorola and we have a license with Motorola to use these engines in our bar code scanning products. We also purchase imagers from Motorola and from other companies for use in our products. We face competition outside of the United States from a product similar to our plug-in bar code scanning card from BeInteractive, from products similar to our Cordless Hand Scanner from Baracoda, and from other competitive laser scanning products from Grabba (Australia) and Opticon (Japan). Motorola's patent position for laser bar code scanning tends to limit the sale of laser scanning bar code products by competitors in the United States, but a number of the Motorola patents will expire over the next several years, and we may face increasing competition from competitors both inside and outside the United States. We produce our laser bar code scanning products under a license from Motorola, which, to date, has not licensed these technologies to potential competitors. Motorola has historically been selective in licensing their technologies to third-parties. The continued availability of our licenses from Motorola and the continued absence of other licensees are dependent upon future licensing decisions by Motorola.

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(Table of Contents)

In addition, companies such as Intermec have improved imager technology making such technology a viable alternative to laser scanning, and we expect both our laser and our imaging products to face more competition over

time from devices deploying imaging technology. Our laser scanning products are targeted to address specific market segments, such as patient medication administration within the health care industry, retail merchandising such as managing inventory on retail store shelves, sales and field force automation involving the collection and processing of orders or service information from remote locations by sales and service personnel, asset management and inventory control for assets having bar codes or radio frequency identification tags, and mobile point of sale applications.

*Connectivity Products - Cable Connections.* We are one of two principal manufacturers of low power Ethernet cards, the other being OvisLink. Our CompactFlash modem cards face competition from a number of manufacturers including Ambicom, Billinton Systems, Hawking, Zonet, OvisLink, Pharos, Trendware and Xircom. There are also a number of competitors that offer Bluetooth modems. These companies include Billinton Systems, ENR Technologies, Motorola, PSI, SiteCom, Sony, Typhoon, Trust, X Micro and Zoom.

*OEM Embedded Products - Wireless Connections.* We offer our wireless connection Bluetooth and Wireless LAN technologies in the form of modules for embedding in third party devices. We also offer CompactFlash plug-in cards and SDIO plug-in cards that may be plugged into the expansion slots of devices needing these technologies. We compete based on our brand name and customer support infrastructure, as well as software enhancements that provide ease-of-use, security features, and monitoring and troubleshooting tools.

Our Bluetooth and WLAN software works well with our hardware, providing us a complete solution for embedding Bluetooth and WLAN wireless connections into third-party devices. Manufacturers in Asia selling primarily hardware, such as Alps, Murata, and TaiyoYuden, along with integrators such as Bluesoft and Stonestreet One, are able to produce all or part of embedded solutions which may compete with our products and services. In addition, manufacturers of products that are sold in high volume may choose to build and support their own Bluetooth or WLAN connections.

Our Wireless LAN cards face competition in the market today principally from other manufacturers of low power Wireless LAN 802.11g cards, including Ambicom for CF cards, and AmbiCom, Spectec and Mobis for SDIO cards. The market for Bluetooth wireless communications technology is highly competitive. A number of companies offer competing CompactFlash Bluetooth cards including Ambicom, Brainboxes and Billinton.

*Serial Interface Products.* Our serial interface card products compete from time to time with similar products from small manufacturers including BeInteractive, Brainboxes, B&B Electronics, Elan Digital Systems, Quatech (now part of DPAC Technologies), and Ratoc Systems. We also offer a cordless serial adapter with Bluetooth wireless technology. Companies that offer competing Bluetooth serial products include AIRcable, Brainboxes, ConnectBlue, Digi International, Ezurio, Free 2 Move, Initium and Wavespeed.

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(Table of Contents)

### **Proprietary Technology**

We have developed a number of technological building blocks that enhance our ability to design new hardware and software products, to offer products which run on multiple software and hardware platforms, and to manufacture and package products efficiently.

One of our most important chip hardware building blocks is our proprietary mobility integrated circuit, which is a highly flexible interface for PC cards and CompactFlash cards that enables our products to work with all major handheld and notebook computers that have PC card or CompactFlash slots, regardless of their design. We have

incorporated our mobility integrated circuit into a broad range of our peripheral products to control signal transmission between these products and the handheld or notebook computer's PC card or CompactFlash slot.

Another area of intellectual property is our expertise in embedded radio-dependent firmware. Within our Bluetooth cordless products are software and firmware that include a wide variety of functions to enable efficient radio control and overall systems functionality. For cordless bar code scanning and radio frequency identification reading, this includes our patented Error Proof Protocol, which is designed to ensure that scanned data is correctly received by the mobile computing device and allow for real-time validation of data and error notification to the user.

We have developed a library of software drivers and control modules that allow our products to operate in handheld computers running the Windows Mobile operating systems and in notebooks running various Windows and third-party operating systems. We have been awarded ten U.S. Patents and seven design patents covering various inventions that relate to mobile products and to the designs of our products. In July 2004 we also acquired from Khyber Technologies a U.S. patent entitled Card Shaped Computer Peripheral Device. The patent is a basic patent covering the design and functioning of plug-in bar code scanners, bar code imagers, and radio frequency identification products. We have additional patents covering our proprietary technology pending with the U.S. Patent and Trademark Office.

We have developed a number of software programs that provide unique functions and features for our connection and data collection products. For example, our SocketScan software enables all of our bar code scanning products to scan a variety of bar codes and to route the scanned data to many different types of data files. Our Bluetooth software used in conjunction with our Bluetooth hardware provides a completely functional Bluetooth solution enabling connections and data transfers between Bluetooth-enabled devices. Our wireless local area network software that is integrated with our wireless local area network management software (which we call Wi-Fi Companion and have introduced a version with Cisco Compatible Extension protocols called Enhanced Wi-Fi Companion or e-WFC) and used in conjunction with our wireless local area network hardware, provides a completely functional wireless local area network solution, enabling connections and data transfers from mobile computing devices over wireless local area networks.

We have registered trademarks with the U.S. Patent and Trademark Office for "Socket" our logo, the term "Go-WiFi" associated with our Wireless LAN products and have a trademark registration pending for "SoMo" for our mobile handheld computer.

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(Table of Contents)

We rely on a combination of patent, copyright, trademark and trade secret laws, and confidentiality procedures to protect our proprietary rights. As part of our confidentiality procedures, we generally enter into non-disclosure agreements with our employees, distributors and strategic partners, and limit access to our software, documentation and other proprietary information. Despite these precautions, it may be possible for a third-party to copy or otherwise obtain and use our products or technology without authorization, or to develop similar technology independently. In addition, we may not be able to effectively protect our intellectual property rights in certain foreign countries. From time to time we receive communications from third-parties asserting that our products infringe, or may infringe, their proprietary rights. In connection with any such claims, litigation could be brought against us that could result in significant additional expenses or compel us to discontinue or redesign some of our products.

**Personnel**

Our future success will depend in significant part upon the continued service of certain of our key technical and senior management personnel, and our continuing ability to attract, assimilate and retain highly qualified technical, managerial and sales and marketing personnel. Our total employee headcount as of December 31, 2007 was 81 people. Our employees are not represented by a union, and we consider our employee relationships to be good.

### **Sales and Marketing**

During the year ended December 31, 2007, 65 percent of our sales were in North America, 27 percent in Europe, and 8 percent in Asia and Pacific Rim countries. During the year ended December 31, 2006, 68 percent of our sales were in North America, 24 percent in Europe and 8 percent in Asia and Pacific Rim countries. During the year ended December 31, 2005, 65 percent of our sales were in North America, 24 percent in Europe, and 11 percent in Asia and Pacific Rim countries. Export sales are subject to the complications of complying with laws of various countries and the risk of import/export restrictions and tariff regulations.

We market our products through a worldwide network of distributors and resellers, as well as through OEMs and VARs. In addition, we have more than 100 companies that are participants in our Vertical Industry Partners Program. Participants offer or intend to offer third-party software applications that utilize our products in their software solutions. Vertical market segments addressed by participants include health care, field force automation, retail merchandising, automotive/transportation, and asset management. Applications include checking patient medications when administering them in a hospital, capturing lot numbers of drug samples given to a doctor, managing the stocking of shelves in retail establishments, entering sales orders from the field, taking inventory of bar coded items, and entering and updating information in an enterprise data base. We support our distributors, resellers and integrators with software developer kits and by providing education, training and customer assistance through our sales, marketing, and technical support staff in the U.S., Europe and Asia-Pacific regions. As of December 31, 2007, we had 32 people in sales and marketing.

Our United States distributor Tech Data Corp. accounted for 23 percent of our revenue in 2007, 26 percent of our revenue in 2006 and 28 percent of our revenue in 2005. Our United States distributor Ingram Micro, Inc. accounted for 13 percent of our revenue in 2007 and 14 percent of our revenue in each of 2006 and 2005. We intend to increase our sales and marketing effort during 2008 by adding personnel and increasing promotional activities, particularly in support of our distributors and vertical industry partners.

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### (Table of Contents)

Consistent with industry practice, we provide our distributors with stock balancing and price protection rights which permit these distributors to return slow-moving products to us for credit, and to receive price adjustments for inventories of our products held by the distributors if we lower the price of those products. The immediate effect of returns and adjustments on our quarterly operating results is limited, since we recognize revenues on products shipped to distributors only at the time the merchandise is sold by the distributor. To date, we have not experienced any significant returns or price protection adjustments.

We rely significantly on our OEMs, distributors, and resellers for marketing and distribution of our products. 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 those of our competitors. If any OEMs, distributors, or resellers reduce or discontinue efforts to sell our products, our revenues and operating results could be materially adversely affected.

## **Manufacturing**

We subcontract the manufacturing of substantially all of our products to independent third-party contract manufacturers who are located in the U.S., China, and Taiwan and who have the equipment, know-how and capacity to manufacture products to our specifications. We perform final product testing and package our products at our Newark, California facility for most of our sales. As of December 31, 2007, we had 24 people employed in manufacturing operations, including planning, buying, manufacturing engineering, quality control, product assembly, shipping and receiving, MIS and product support. We augment this workforce with temporary employees on an as-needed basis.

Certain of our product components are available from only one vendor. These sole sourced components include the interface chip that controls the signal transmission between all of our plug-in CompactFlash products (except our Ethernet and Wireless LAN cards) and the card slot on the mobile computer, our Ethernet and Wireless LAN chips, our laser scanning engines, our SDIO plug-in cards, certain cable and connector components and, beginning in 2007, our mobile handheld computer. Although to date we have generally been able to obtain adequate supplies of these components, these components are generally purchased on a purchase order basis under standard commercial terms and conditions, and we do not have long-term supply contracts for these components. Accordingly, the manufacturers could stop providing these components to us at any time. Alternatively, although our suppliers are generally large, well-financed organizations, they could encounter financial difficulties that interfere with our product supplies. In such an event, we could experience a decline in revenues until we establish sufficient manufacturing supply through an alternative source. Locating and qualifying alternative suppliers, and commencing new manufacturing operations, could take a significant period of time, although we believe that we can relocate manufacturing or find alternative suppliers for sole sourced components should it become necessary. We generally stock higher inventory quantities of sole sourced components as safety stocks to mitigate the risk of supply disruption.

## (Table of Contents)

## **Research and Development**

Since our inception, we have made substantial investments in research and development. Research and development expenditures were \$5.0 million in 2007, \$5.1 million in 2006, and \$3.5 million in 2005. The increased expenditures in 2007 and 2006 were in part due to an increase in the number of development projects including the removal of lead from our products as required by the Reduction in Hazardous Substances Act and new product development costs for our cordless ring scanner, our mobile handheld computer and our software programs including SocketScan, Wireless LAN and Bluetooth. We believe that our future performance will depend in large part on our ability to develop significant enhancements to our existing products, including technology upgrades and additional features, and to develop successful new products for emerging and existing markets.

As of December 31, 2007, we had 16 people on our product development staff, and we hire engineering consultants to perform additional engineering services as required. We anticipate that we will continue to commit substantial resources to research and development in the future.

## **General and Administration**

As of December 31, 2007, we had 9 people responsible for our financial and administrative activities including accounting and finance, personnel, and administrative support.

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(Table of Contents)**Item 1A. Risk Factors****We have a history of operating losses and may not achieve ongoing profitability.**

We were unprofitable in each of the quarters in fiscal years 2007 and 2006. We were profitable in two quarters in 2005, but unprofitable for fiscal year 2005. Fiscal year 2004 was the first profitable year in our history, but only to the extent of \$288,000. Prior to 2004, we incurred significant operating losses in each financial period since our inception. To achieve ongoing profitability, we must accomplish numerous objectives, including growth in our business and the development of successful new products. We cannot foresee with any certainty whether we will be able to achieve these objectives in the future. Accordingly, we may not generate sufficient net revenue to achieve ongoing profitability. If we cannot achieve ongoing profitability, we will not be able to support our operations from positive cash flows, and we would use our existing cash to support operating losses. If we are unable to secure the necessary capital to replace that cash, we may need to suspend some or all of our current operations.

**We may require additional capital in the future, but that capital may not be available on reasonable terms, if at all, or on terms that would not cause substantial dilution to your stock holdings.**

Although we do not anticipate the need to raise additional capital during the next twelve months to fund our operations, we may incur operating losses in future quarters and may need to raise capital to fund these losses. Our forecasts are highly dependent on factors beyond our control, including market acceptance of our products and sales of handheld computers. If capital requirements vary materially from those currently planned, we may require additional capital sooner than expected. There can be no assurance that such capital will be available in sufficient amounts or on terms acceptable to us, if at all. In addition, the availability of our bank line is dependent upon our meeting certain covenants, including maintaining minimum cash balances. Future operating losses could cause us to lose the availability of our bank line as a result of becoming non-compliant with these covenants.

**Our Common Stock will become ineligible for listing on the NASDAQ Global Market or alternatively the NASDAQ Capital Market if it does not trade at or above \$1.00, which would materially adversely affect the liquidity and price of our Common Stock.**

We are listed on the NASDAQ Global Market. Our continued listing is contingent on meeting specific quantitative standards, including a minimum closing bid price of \$1.00. Our Common Stock has traded below \$1.00 for significant periods during the last twelve months. In particular, our stock failed to maintain a minimum closing bid price of at least \$1.00 in the 30 consecutive business days prior to December 10, 2007. On December 10, 2007 we received a staff deficiency notice from the Listing Qualifications Department of the NASDAQ Stock Market which stated that our stock will have to achieve a minimum closing bid price of at least \$1.00 for at least 10 consecutive business days within 180 calendar days, or by June 9, 2008, or else we may be delisted from the NASDAQ Global Market. As of March 6, 2008, our Common Stock has not achieved the minimum closing bid price of \$1.00 on any single day since receipt of the deficiency notice. Should we be delisted from the NASDAQ Global Market, we may be eligible for listing on the NASDAQ Capital Market, subject to meeting specific quantitative standards, including maintaining a minimum closing bid price of \$1.00, and would have to achieve that within the 180 calendar days of initial listing on the NASDAQ Capital Market.



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(Table of Contents)

If our Common Stock becomes ineligible for listing on either the NASDAQ Global Market or the NASDAQ Capital Market, and is thereafter traded only on the over-the-counter market, our stockholders' abilities to purchase and sell our Common Stock could be less orderly and efficient and more costly. Furthermore, a delisting of our Common Stock could have a materially adverse impact on our business operations by damaging our general business reputation, impairing our ability to obtain additional capital, reducing the incentives that equity ownership is intended to provide to our employees, and causing a loss of confidence by investors, suppliers and employees. As a result of the negative impact on the liquidity of our Common Stock and on our business, a delisting would also likely decrease the market price of our Common Stock and increase the volatility of our stock price.

**If third parties do not produce and sell innovative products with which our products are compatible, or if our line of mobile handheld computers is not successful, we may not achieve our sales projections.**

Our success has been dependent upon the ability of third parties in the mobile personal computer industry to complete development of products that include or are compatible with our technology and then to sell these products into the marketplace. Even if we are successful in marketing and selling our new line of mobile handheld computers, our ability to generate increased revenue depends significantly on the commercial success of Windows-mobile handheld devices, particularly the Pocket PC and other devices such as the line of handhelds with expansion options offered by Palm, and the adoption of these handheld computers for business use. If manufacturers are unable or choose not to ship new products such as Pocket PC and other Windows-mobile devices or Palm devices, or experience difficulties with new product transitions that cause delays in the market as we experienced in fiscal years 2005, 2006 and 2007, or if these products, including our new line of mobile handheld computers of which we began shipping our first model in June of 2007, fail to achieve or maintain market acceptance, the number of our potential new customers would be reduced and we would not be able to meet our sales expectations.

**If we fail to develop and introduce new products rapidly and successfully, we will not be able to compete effectively, and our ability to generate sufficient revenues will be negatively affected.**

The market for our products is prone to rapidly changing technology, evolving industry standards and short product life cycles. If we are unsuccessful at developing and introducing new products and services on a timely basis that include the latest technologies conforming to the newest standards and that are appealing to end users, we will not be able to compete effectively, and our ability to generate significant revenues will be seriously harmed.

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(Table of Contents)

The development of new products and services can be very difficult and requires high levels of innovation. The development process is also lengthy and costly. Short product life cycles expose our products to the risk of obsolescence and require frequent new product introductions. We will be unable to introduce new products and services into the market on a timely basis and compete successfully, if we fail to:

- identify emerging standards in the field of mobile computing products;
- enhance our products by adding additional features;
- invest significant resources in research and development, sales and marketing, and customer support;

- maintain superior or competitive performance in our products; and
- anticipate our end users' needs and technological trends accurately.

We cannot be sure that we will have sufficient resources to make adequate investments in research and development or that we will be able to identify trends or make the technological advances necessary to be competitive.

**A significant portion of our revenue currently comes from two distributors, and any decrease in revenue from these distributors could harm our business.**

A significant portion of our revenue comes from two distributors, Tech Data Corp. and Ingram Micro, Inc., which together represented approximately 36 percent, 40 percent, and 42 percent of our worldwide revenue in fiscal years 2007, 2006, and 2005, respectively. We expect that a significant portion of our revenue will continue to depend on sales to Tech Data Corp. and Ingram Micro, Inc. We do not have long-term commitments from Tech Data Corp. or Ingram Micro, Inc. to carry our products. Either could choose to stop selling some or all of our products at any time, and each of these companies also carries our competitors' products. If we lose our relationship with Tech Data Corp. or Ingram Micro, Inc., we would experience disruption and delays in marketing our products.

**If the market for mobile computers experiences delays, or fails to grow, we will not achieve our sales projections.**

Substantially all of our peripheral products are designed for use with mobile personal computers, including handhelds, notebook computers, tablets and smartphones. If the mobile personal computer industry does not grow, if its growth slows, or if product or operating system changeovers by mobile computer manufacturers and partners cause delays in the market, as we experienced in the past three years, or if the markets for our mobile handheld computers do not grow, we will not achieve our sales projections.

**Our sales will be hurt if the new technologies used in our products do not become widely adopted, or are adopted slower than expected.**

Many of our products use new technologies, such as 2D bar code scanning and radio frequency identification, which are not yet widely adopted in the market. If these technologies fail to become widespread, or are adopted slower than expected, our sales will suffer.

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(Table of Contents)

**We could face increased competition in the future, which would adversely affect our financial performance.**

The market for handheld computers in which we operate is very competitive. Our future financial performance is contingent on a number of unpredictable factors, including that:

- some of our competitors have greater financial, marketing, and technical resources than we do;
- we periodically face intense price competition, particularly when our competitors have excess inventories and discount their prices to clear their inventories; and
- certain OEMs of personal computers, mobile phones and handheld computers offer built-in functions, such as Bluetooth wireless technology, Wi-Fi, or bar code scanning, that compete with our products.

Increased competition could result in price reductions, fewer customer orders, reduced margins, and loss of market share. Our failure to compete successfully against current or future competitors could harm our business, operating results and financial condition.

**If we do not correctly anticipate demand for our products, our operating results will suffer.**

The demand for our products depends on many factors and is difficult to forecast. We expect that it will become more difficult to forecast demand as we introduce and support more products and as competition in the market for our products intensifies. If demand increases beyond forecasted levels, we would have to rapidly increase production at our third party manufacturers. We depend on suppliers to provide additional volumes of components, and suppliers might not be able to increase production rapidly enough to meet unexpected demand. Even if we were able to procure enough components, our third party manufacturers might not be able to produce enough of our devices to meet our customer demand. In addition, rapid increases in production levels to meet unanticipated demand could result in higher costs for manufacturing and supply of components and other expenses. These higher costs could lower our profit margins. Further, if production is increased rapidly, manufacturing yields could decline, which may also lower operating results.

If demand is lower than forecasted levels, we could have excess production resulting in higher inventories of finished products and components, which could lead to write-downs or write-offs of some or all of the excess inventories, and reductions in our cash balances. Lower than forecasted demand could also result in excess manufacturing capacity at our third party manufacturers and in our failure to meet minimum purchase commitments, each of which may lower our operating results.

**We rely primarily on distributors, resellers, and OEMs to sell our products, and our sales would suffer if any of these third parties stops selling our products effectively.**

Because we sell our products primarily through distributors, resellers, and OEMs, we are subject to risks associated with channel distribution, such as risks related to their inventory levels and support for our products. Our distribution channels may build up inventories in anticipation of growth in their sales. If such growth in their sales does not occur as anticipated, the inventory build up could contribute to higher levels of product returns. The lack of sales by any one significant participant in our distribution channels could result in excess inventories and adversely affect our operating results.

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(Table of Contents)

Our agreements with distributors, resellers, and OEMs are generally nonexclusive and may be terminated on short notice by them without cause. Our distributors, resellers, and OEMs are not within our control, are not obligated to purchase products from us, and may offer competitive lines of products simultaneously. Sales growth is contingent in part on our ability to enter into additional distribution relationships and expand our sales channels. We cannot predict whether we will be successful in establishing new distribution relationships, expanding our sales channels or maintaining our existing relationships. A failure to enter into new distribution relationships or to expand our sales channels could adversely impact our ability to grow our sales.

We allow our distribution channels to return a portion of their inventory to us for full credit against other purchases. In addition, in the event we reduce our prices, we credit our distributors for the difference between the purchase price of products remaining in their inventory and our reduced price for such products. Actual returns and price protection may adversely affect future operating results, particularly since we seek to continually introduce new and enhanced

products and are likely to face increasing price competition.

**We depend on alliances and other business relationships with a small number of third parties, and a disruption in any one of these relationships would hinder our ability to develop and sell our products.**

We depend on strategic alliances and business relationships with leading participants in various segments of the communications and mobile handheld computer markets to help us develop and market our products. Our strategic partners may revoke their commitment to our products or services at any time in the future or may develop their own competitive products or services. Accordingly, our strategic relationships may not result in sustained business alliances, successful product or service offerings, or the generation of significant revenues. Failure of one or more of such alliances could result in delay or termination of product development projects, failure to win new customers, or loss of confidence by current or potential customers.

We have devoted significant research and development resources to design activities for Windows-mobile products, Palm devices, smartphones using Windows Mobile and Symbian System 60 and 80 operating systems, and more recently, to develop our own family of mobile handheld computers. Such design activities have diverted financial and personnel resources from other development projects. These design activities are not undertaken pursuant to any agreement under which Microsoft, Palm, or Symbian is obligated to continue the collaboration or to support the products produced from the collaboration. Consequently, these organizations may terminate their collaborations with us for a variety of reasons, including our failure to meet agreed-upon standards or for reasons beyond our control, such as changing market conditions, increased competition, discontinued product lines, and product obsolescence.

**Our intellectual property and proprietary rights may be insufficient to protect our competitive position.**

Our business depends on our ability to protect our intellectual property. We rely primarily on patent, copyright, trademark, trade secret laws, and other restrictions on disclosure to protect our proprietary technologies. We cannot be sure that these measures will provide meaningful protection for our proprietary technologies and processes. We cannot be sure that any patent issued to us will be sufficient to protect our technology. The failure of any patents to provide protection to our technology would make it easier for our competitors to offer similar products. In connection with our participation in the development of various industry standards, we may be required to license certain of our patents to other parties, including our competitors, that develop products based upon the adopted standards.

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(Table of Contents)

We also generally enter into confidentiality agreements with our employees, distributors, and strategic partners, and generally control access to our documentation and other proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our products, services, or technology without authorization, develop similar technology independently, or design around our patents.

Effective copyright, trademark, and trade secret protection may be unavailable or limited in certain foreign countries. Furthermore, certain of our customers have entered into agreements with us which provide that the customers have the right to use our proprietary technology in the event we default in our contractual obligations, including product supply obligations, and fail to cure the default within a specified period of time.

**We may become subject to claims of intellectual property rights infringement, which could result in substantial liability.**

In the course of operating our business, we may receive claims of intellectual property infringement or otherwise become aware of potentially relevant patents or other intellectual property rights held by other parties. Many of our competitors have large intellectual property portfolios, including patents that may cover technologies that are relevant to our business. In addition, many smaller companies, universities, and individuals have obtained or applied for patents in areas of technology that may relate to our business. The industry is moving towards aggressive assertion, licensing, and litigation of patents and other intellectual property rights. In June 2007, we received a letter from Wi-LAN Inc., accusing certain of our wireless LAN products of infringing two U.S. and one Canadian patent held by Wi-LAN Inc. In October 2007, Wi-LAN Inc. filed patent infringement lawsuits against a number of companies alleging that those companies infringe the two U.S. patents by manufacturing, using, or offering for sale products with wireless capability compliant with the IEEE 802.11 standards. Wi-LAN Inc. is asking for money damages and a court order barring the sale of products that use the patented technology. We have not been named in the lawsuit, and we do not plan to make any changes to our current business at this time. Nonetheless, we may be added to the lawsuit in the future, and even if we are not, the outcome of this lawsuit may result in future changes to our business, including potential increased costs for those of our products that make use of the related technology. In October 2007, we received a letter from WIAV Solutions, LLC, offering to license the wireless technology covered by two U.S. patents held by WIAV Solutions, LLC. To date we have not entered into discussions to license their technology.

If we are unable to obtain and maintain licenses on favorable terms for intellectual property rights required for the manufacture, sale, and use of our products, particularly those products which must comply with industry standard protocols and specifications to be commercially viable, our results of operations or financial condition could be adversely impacted.

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(Table of Contents)

In addition to disputes relating to the validity or alleged infringement of other parties' rights, we may become involved in disputes relating to our assertion of our own intellectual property rights. Whether we are defending the assertion of intellectual property rights against us or asserting our intellectual property rights against others, intellectual property litigation can be complex, costly, protracted, and highly disruptive to business operations by diverting the attention and energies of management and key technical personnel. Plaintiffs in intellectual property cases often seek injunctive relief, and the measures of damages in intellectual property litigation are complex and often subjective or uncertain. Thus, any adverse determinations in this type of litigation could subject us to significant liabilities and costs.

**New industry standards may require us to redesign our products, which could substantially increase our operating expenses.**

Standards for the form and functionality of our products are established by standards committees. These independent committees establish standards, which evolve and change over time, for different categories of our products. We must continue to identify and ensure compliance with evolving industry standards so that our products are interoperable and we remain competitive. Unanticipated changes in industry standards could render our products incompatible with products developed by major hardware manufacturers and software developers. Should any major changes, even if anticipated, occur, we would be required to invest significant time and resources to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, we would miss opportunities to sell our products for use with new hardware components from mobile computer manufacturers and OEMs, thus affecting our business.

**Undetected flaws and defects in our products may disrupt product sales and result in expensive and time-consuming remedial action.**

Our hardware and software products may contain undetected flaws, which may not be discovered until customers have used the products. From time to time, we may temporarily suspend or delay shipments or divert development resources from other projects to correct a particular product deficiency. Efforts to identify and correct errors and make design changes may be expensive and time consuming. Failure to discover product deficiencies in the future could delay product introductions or shipments, require us to recall previously shipped products to make design modifications, or cause unfavorable publicity, any of which could adversely affect our business and operating results.

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(Table of Contents)

**Our quarterly operating results may fluctuate in future periods, which could cause our stock price to decline.**

We expect to experience quarterly fluctuations in operating results in the future. We generally ship orders as received, and as a result we may have little backlog. Quarterly revenues and operating results therefore depend on the volume and timing of orders received during the quarter, which are difficult to forecast. Historically, we have often recognized a substantial portion of our revenue in the last month of the quarter. This subjects us to the risk that even modest delays in orders may adversely affect our quarterly operating results. Our operating results may also fluctuate due to factors such as:

- the demand for our products;
- the size and timing of customer orders;
- unanticipated delays or problems in our introduction of new products and product enhancements;
- the introduction of new products and product enhancements by our competitors;
- the timing of the introduction of new products that work with our connection products;
- changes in the revenues attributable to royalties and engineering development services;
- product mix;
- timing of software enhancements;
- changes in the level of operating expenses;
- competitive conditions in the industry including competitive pressures resulting in lower average selling prices; and
- timing of distributors' shipments to their customers.

Because we base our staffing and other operating expenses on anticipated revenues, delays in the receipt of orders can cause significant variations in operating results from quarter to quarter. As a result of any of the foregoing factors, or a combination, our results of operations in any given quarter may be below the expectations of public market analysts or investors, in which case the market price of our common stock would be adversely affected.

**The loss of one or more of our senior personnel could harm our existing business.**

A number of our officers and senior managers have been employed for thirteen to sixteen years by us, including our President, Executive Vice President, Chief Financial Officer, and Chief Technical Officer. Our future success will depend upon the continued service of key officers and senior managers. Competition for officers and senior managers is intense, and there can be no assurance that we will be able to retain our existing senior personnel. The loss of one or more of our officers or key senior managers could adversely affect our ability to compete.

**Beginning January 1, 2006 we began to expense options granted under our employee stock plans as compensation, and as a result our net income and earnings per share were negatively affected, we may continue to have net losses as a result of the requirement to expense options, and may find it necessary to change our**

**business practices to attract and retain employees.**

Historically, we have used stock options as a key component of our employee compensation packages. We believe that stock options provide an incentive to our employees to maximize long-term stockholder value and, through the use of vesting, encourage valued employees to remain with us. The expensing of employee stock options adversely affected our net income and earnings per share in each of the quarters in fiscal years 2007 and 2006, will continue to adversely affect future quarters, and will make profitability harder to achieve or make our future profits or net losses worse. In addition, we may decide in response to the effects of expensing stock options on our operating results to reduce the number of stock options granted to employees or to grant options to fewer employees. This could adversely affect our ability to retain existing employees and attract qualified candidates, and also could increase the cash compensation we would have to pay to them.

(Table of Contents)

**If we are unable to attract and retain highly skilled sales and marketing and product development personnel, our ability to develop and market new products and product enhancements will be adversely affected.**

We believe our ability to achieve increased revenues and to develop successful new products and product enhancements will depend in part upon our ability to attract and retain highly skilled sales and marketing and product development personnel. Our products involve a number of new and evolving technologies, and we frequently need to apply these technologies to the unique requirements of mobile products. Our personnel must be familiar with both the technologies we support and the unique requirements of the products to which our products connect. Competition for such personnel is intense, and we may not be able to attract and retain such key personnel. In addition, our ability to hire and retain such key personnel will depend upon our ability to raise capital or achieve increased revenue levels to fund the costs associated with such key personnel. Failure to attract and retain such key personnel will adversely affect our ability to develop and market new products and product enhancements.

**We may not be able to collect revenues from customers who experience financial difficulties.**

Our accounts receivable are derived primarily from distributors and OEMs. We perform ongoing credit evaluations of our customers' financial conditions but generally require no collateral from our customers. Reserves are maintained for potential credit losses, and such losses have historically been within such reserves. However, many of our customers may be thinly capitalized and may be prone to failure in adverse market conditions. Although our collection history has been good, from time to time a customer may not pay us because of financial difficulty, bankruptcy or liquidation.

**We may be unable to manufacture our products, because we are dependent on a limited number of qualified suppliers for our components.**

Several of our component parts, including our serial interface chip, our Ethernet chip, our bar code scanning modules, and our new line of mobile handheld computers, are produced by one or a limited number of suppliers. Shortages could occur in these essential components due to an interruption of supply or increased demand in the industry. If we are unable to procure certain component parts, we could be required to reduce our operations while we seek alternative sources for these components, which could have a material adverse effect on our financial results. To the extent that we acquire extra inventory stocks to protect against possible shortages, we would be exposed to additional risks associated with holding inventory, such as obsolescence, excess quantities, or loss.

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(Table of Contents)

**Our operating results could be harmed by economic, political, regulatory and other risks associated with export sales.**

Export sales (sales to customers outside the United States) accounted for approximately 35 percent, 32 percent, and 35 percent, of our revenues in fiscal years 2007, 2006, and 2005, respectively. Accordingly, our operating results are subject to the risks inherent in export sales, including:

- longer payment cycles;
- unexpected changes in regulatory requirements, import and export restrictions and tariffs;
- difficulties in managing foreign operations;
- the burdens of complying with a variety of foreign laws;
- greater difficulty or delay in accounts receivable collection;
- potentially adverse tax consequences; and
- political and economic instability.

Our export sales are primarily denominated in United States dollars and in Euros for our sales to European distributors. Accordingly, an increase in the value of the United States dollar relative to foreign currencies could make our products more expensive and therefore potentially less competitive in foreign markets. Declines in the value of the Euro relative to the United States dollar may result in foreign currency losses relating to collection of Euro denominated receivables if left unhedged.

**Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, and other events beyond our control.**

Our corporate headquarters is located near an earthquake fault. The potential impact of a major earthquake on our facilities, infrastructure, and overall business is unknown. Additionally, we may experience electrical power blackouts or natural disasters that could interrupt our business. Should a disaster be widespread, such as a major earthquake, or result in the loss of key personnel, we may not be able to implement our disaster recovery plan in a timely manner. Any losses or damages incurred by us as a result of these events could have a material adverse effect on our business.

**Failure to maintain effective internal controls could have a material adverse effect on our business, operating results and stock price.**

We have evaluated and will continue to evaluate our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires an annual management assessment of the design and effectiveness of our internal controls over financial reporting. If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.



**The sale of a substantial number of shares of common stock could cause the market price of our common stock to decline.**

Sales of a substantial number of shares of our common stock in the public market could adversely affect the market price for our common stock. The market price of our common stock could also decline if one or more of our significant stockholders decided for any reason to sell substantial amounts of our common stock in the public market.

As of February 29, 2008, we had 32,015,975 shares of common stock outstanding. Substantially all of these shares are freely tradable in the public market, either without restriction or subject, in some cases, only to S-3 prospectus delivery requirements and, in other cases, only to manner of sale, volume, and notice requirements of Rule 144 under the Securities Act.

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(Table of Contents)

As of February 29, 2008, we had 10,947,309 shares subject to outstanding options under our stock option plans, and 1,149,737 shares were available for future issuance under the plans. We have registered the shares of common stock subject to outstanding options and reserved for issuance under our stock option plans. Accordingly, shares underlying vested options will be eligible for resale in the public market as soon as the options are exercised.

As of February 29, 2008, we had warrants outstanding to purchase a total of 918,810 shares of our common stock at exercise prices ranging from \$0.722 to \$2.73. All such warrants may be exercised at any time, and the shares issuable upon exercise may be resold, either without restrictions or subject, in some cases, only to S-3 prospectus delivery requirements, and, in some cases, only to manner of sale, volume, and notice requirements of Rule 144.

**Volatility in the trading price of our common stock could negatively impact the price of our common stock.**

During the period from January 1, 2006 through February 29, 2008, our common stock price fluctuated between a high of \$1.75 and a low of \$0.59. The trading price of our common stock could be subject to wide fluctuations in response to many factors, some of which are beyond our control, including general economic conditions and the outlook of securities analysts and investors on our industry. In addition, the stock markets in general, and the markets for high technology stocks in particular, have experienced high volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We lease a 37,100 square foot office facility in Newark, California under a lease expiring in June 2012. We have one option to extend the term of the lease for an additional five-year period with respect to the entire premises. This facility houses our headquarters and manufacturing operations. We believe that our current facilities are sufficient and adequate to meet our needs for the foreseeable future.

**Item 3. Legal Proceedings**

We are currently not a party to any material legal proceedings.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted for vote by security holders during the fourth quarter of 2007.

25

(Table of Contents)

**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities****Common Stock**

The Company's Common Stock is traded on the NASDAQ Global Market under the symbol "SCKT."

The quarterly high and low sales prices of our Common Stock, as reported on the NASDAQ Global Market through February 29, 2008, and for the last two fiscal years are as shown below:

Quarter Ended	Common Stock	
	High	Low
<b>2006</b>		
March 31, 2006	\$ 1.48	\$ 1.06
June 30, 2006	\$ 1.75	\$ 1.05
September 30, 2006	\$ 1.36	\$ 0.81
December 31, 2006	\$ 1.25	\$ 0.72
<b>2007</b>		
March 31, 2007	\$ 1.40	\$ 0.80
June 30, 2007	\$ 1.03	\$ 0.79
September 30, 2007	\$ 1.05	\$ 0.85
December 31, 2007	\$ 1.33	\$ 0.71
<b>2008</b>		
March 31, 2008 (through February 29, 2008)	\$ 0.89	\$ 0.59

On February 29, 2008, the closing sales price for our common stock as reported on the NASDAQ Global Market was \$0.73. We had approximately 6,300 beneficial stockholders of record as of February 25, 2008. We have not paid dividends on our common stock, and we currently intend to retain future earnings for use in our business and do not anticipate paying dividends in the foreseeable future.

The information required by this item regarding equity compensation plans is incorporated by reference to the information set forth in Item 12 of this Annual Report on Form 10-K.

(Table of Contents)

### **Performance Graph**

The performance graph shown below shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities under that section, and shall not be deemed to be incorporated by reference into any filing of Socket Communications, Inc. under the Securities Act of 1933, as amended, or the Exchange Act. The performance graph below shows a five-year comparison of cumulative total stockholder return, calculated on a dividend reinvestment basis and based on a \$100 investment, from December 31, 2002 through December 31, 2007 comparing the return on the Company's common stock with the Russell 2000 Index and the NASDAQ Computer & Data Processing Index. No dividends have been declared or paid on the common stock during such period. Historical stock price performance is not necessarily indicative of future stock price performance.

(Table of Contents)

**Item 6. Selected Consolidated Financial Data**

The following selected consolidated financial data should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the consolidated financial statements and the notes thereto in Item 8, "Financial Statements and Supplementary Data."

(Amounts in thousands except per share)	Year Ended December 31					
	2003	2004	2005	2006	2007	
<b>Income Statement Data:</b>						
Revenue	\$ 21,611	\$ 26,130	\$ 25,034	\$ 24,981	\$ 24,118	
Gross profit	\$ 10,703	\$ 13,362	\$ 12,589	\$ 12,191	\$ 11,873	
Operating expenses	\$ 11,915	\$ 13,052	\$ 12,843	\$ 15,120	\$ 15,261	(a)
Net income (loss) applicable to common stockholders	\$ (1,952)	\$ 338	\$ (215)	\$ (2,923)	\$ (3,340)	(a)
Net income (loss) per share applicable to common stockholders	\$ (0.07)	\$ 0.01	\$ (0.01)	\$ (0.09)	\$ (0.10)	
Weighted average shares outstanding:						
&nbsp;&nbsp;&nbsp;Basic	26,301	30,061	30,181	31,447	31,929	
&nbsp;&nbsp;&nbsp;Diluted	26,301	33,976	30,181	31,447	31,929	

	At December 31,					
	2003	2004	2005	2006	2007	
<b>Balance Sheet Data:</b>						
Total assets	\$ 23,266	\$ 24,400	\$ 23,635	\$ 22,787	\$ 21,974	
Bank line of credit	\$ 1,567	\$ 2,949	\$ 2,309	\$ 2,213	\$ 2,622	
Capital leases and deferred rent - long term portion	\$ 71	\$ 51	\$ 8	\$ ---	\$ 140	
Preferred stock	\$ 1	\$ 1	\$ 1	\$ ---	\$ ---	
Total stockholders' equity	\$ 16,498	\$ 16,952	\$ 16,814	\$ 15,751	\$ 13,534	
Dividends and preferred stock accretion	\$ 702	\$ 50	\$ 48	\$ 11	\$ ---	

(a) In 2007, operating expenses and the net loss applicable to common stockholders includes stock compensation expense of \$0.9 million and \$1.0 million, respectively. In 2006, operating expenses and the net loss applicable to common stockholders includes stock compensation expense of \$1.1 million and \$1.2 million, respectively. On January 1, 2006, we adopted Financial Accounting Standard SFAS 123R, "Share-Based Payment." SFAS 123R requires the valuation of compensatory stock option grants and the expensing of the fair market value of these grants over the vesting period of the grants. Prior to fiscal 2006, we accounted for stock option grants to our employees and directors in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25), and reported in accordance with the disclosure-only alternative described in SFAS 123, "Accounting for Stock-Based Compensation."

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(Table of Contents)

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****Critical Accounting Policies**

Our significant accounting policies are described in Note 1 to our consolidated financial statements for the year ended December 31, 2007. The application of these policies requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on a combination of historical experience and reasonable judgment applied to other facts. Actual results may differ from these estimates, and such differences may be material to the financial statements. In addition, the use of different assumptions or judgments may result in different estimates. We believe our critical accounting policies that are subject to these estimates are: Revenue Recognition and Accounts Receivable Reserves, Inventory Valuation, and Valuation of Goodwill and Other Intangible Assets.

#### *Revenue Recognition and Accounts Receivable Reserves*

We defer revenue recognition on products sold to distributors until our distributors sell the products to their customers, because our distributors generally have rights to return products to us for stock rotation, stock reduction, or replacement of defective product. The amount of deferred revenue net of related cost of revenue is classified as deferred income on shipments to distributors on our balance sheet. We use inventory reports received from our distributors at the end of each reporting period to determine the extent of inventory at the distributor, and thus, the amount of income to defer. Stock rotation and stock reduction from our distributors generally results in a balance sheet adjustment to our deferred income and does not impact our revenue or cost of revenue.

We generally recognize revenues on sales to customers other than distributors upon shipment provided that persuasive evidence of a sales arrangement exists, the price is fixed and determinable, title has transferred, collection of resulting receivables is reasonably assured, there are no customer acceptance requirements, and there are no remaining significant obligations. Most of our customers other than distributors do not have rights of return except under warranty.

We estimate the amount of uncollectible receivables at the end of each reporting period based on the aging of the receivable balance, historical trends, and communications with our customers. If actual bad debts are significantly different from our estimates our operating results will be affected.

#### *Inventory Valuation*

Our inventories primarily consist of component parts used to assemble our products after we receive orders from our customers. We purchase or have manufactured the component parts required by our engineering bill of materials. The timing and quantity of our purchases are based on order forecasts, the lead time requirements of our vendors, and on economic order quantities. At the end of each reporting period, we compare our inventory on hand to our forecasted requirements for the next nine-month period, and write off the cost of any inventory that is surplus, less any amounts that we believe we can recover from disposal of goods that we specifically believe will be saleable past a nine-month horizon. Our sales forecasts are based upon historical trends, communications from customers, and marketing data regarding market trends and dynamics, which we discuss in Item 1, Business. Surplus or obsolete inventory can also be created by changes to our engineering bill of materials. Charges for the amounts we record as surplus or obsolete inventory are included in cost of revenue.

Our acquisition of the CompactFlash Bluetooth card business, including a product line and technology license, from Nokia Corporation in March 2002 and our acquisition of 3rd Rail Engineering in October 2000 added goodwill and intangible assets to our balance sheet. We allocated the purchase price of each based on an analysis of the fair market value of the assets we acquired. Beginning with the first quarter of 2002, in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," we ceased amortizing goodwill, and began to evaluate periodically whether the value of the goodwill was impaired, at which time any impaired balances would be written down. We currently perform an evaluation of goodwill on a quarterly basis. We also evaluate on a quarterly basis our intangible and other long lived assets for potential impairment indicators. Our judgments regarding the existence of impairment indicators are based on legal factors, market conditions and operational performance of our acquired businesses. In addition, we also review the market capitalization of the Company in conjunction with our analysis of goodwill impairment. As of December 31, 2007, in our judgment, there is no impairment of goodwill or intangible assets. Future events could cause us to conclude that impairment indicators exist and that goodwill and intangible assets associated with our acquired businesses are impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

### **Overview of Our Business**

We are a producer of mobile systems serving the business market. Mobile systems solutions typically consist of a handheld computer, data collection and connectivity peripherals, and third-party vertical applications software. We have historically offered a wide range of data collection and connectivity peripheral products and embedded products for use with mobile computing devices offered by third-parties. Commencing in June 2007, we introduced a mobile handheld computer and began offering mobile systems for use with third-party vertical applications software. For a complete description of our products see "Products" in section Item 1. Business. We work with more than 100 software integration companies that are offering or developing vertical application software for use with handheld computers, including patient medication administration within the health care industry, retail merchandising, sales and field force automation, asset management and inventory control, and mobile point of sale applications. These mobile solutions are designed to improve the productivity of business enterprises by automating manual tasks, improving the quality of information collected, and enhancing mobile productivity.

The guiding principles that we follow in developing products for the mobile systems solutions market are standard form factors, low battery power consumption, ease of use, interoperability and quality. Our products are designed to address the growing need for mobile workforce connectivity by enabling the use of handheld computers to extend data communications capabilities beyond location-dependent wired networks or telephone lines, thereby enabling handheld computer users to enhance their productivity, exploit time sensitive opportunities and improve customer satisfaction. Overall, our products enable the integration of hardware, software and applications into complete mobile data collection and connectivity solutions.

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### (Table of Contents)

The overall market for data collection and connectivity products is both complex and competitive. Our products compete with similar products that are manufactured by companies in Asia and Europe. However, our longtime focus on creating innovative data collection and connectivity solutions for the mobile workforce has resulted in good brand name recognition and reputation. We also believe that our brand name identifies our products as robust, dependable, small form factor, low power and easy to use, and the breadth of our product offerings, including the extensive features of our software, will continue to differentiate us relative to our competitors. The addition of a mobile handheld computer in 2007 enables us to better control the handheld computing environment for our peripheral products and allows us to offer one-stop shopping for the hardware portion of mobile business solutions.

We sell both Socket-branded and OEM products. We distribute our Socket-branded products through worldwide general distribution channels, and sell our OEM products directly to OEMs. We have a leveraged business model in both manufacturing and distribution that is designed to allow the benefits of revenue growth to benefit our operating results. Most of our major product components are manufactured to our specifications by third-party contract manufacturers, and we handle final product assembly, testing and distribution. This arrangement allows us to expand volume production without a corresponding need to invest in additional manufacturing equipment or manufacturing personnel, and increases in the volumes of products we have our suppliers manufacture tends to reduce the unit costs they charge us, as the costs of production startup are spread over more units. We distributed 76 percent of our products (all but our OEM products) during 2007 through worldwide general distribution channels. We have in place the infrastructure to manage our distribution channels and are capable of increasing the volume of business in these channels with our current resources. Sixty-five percent of our products were sold in the United States, and thirty five percent sold in Europe and Asia during 2007.

We price our products towards the customer who is looking for a dependable, robust product, not necessarily the most inexpensive, and we have typically achieved gross margins around 49 to 50 percent. We believe that of our products those that face the most competition are our connectivity products, which tend to have lower product margins than our data collection, OEM and serial products. As a result, our margins are affected by product sales mix. We will also provide customer discounts for volume orders; thus order size can affect our margins. Inventory charges such as reserves for excess and obsolete inventory are also charged to cost of sales and can impact our margins.

Overall revenues in 2007 declined by 3 percent from revenues in 2006. Fiscal 2007 was a year of change as we transitioned from being a peripherals supplier to a mobile system solutions supplier for the business mobility market. We outlined a new strategic direction at the beginning of 2007 around the introduction of our first mobile handheld computer, the SoMo 650, which was designed expressly for business applications. We began shipping initial units of our mobile handheld computer in June of 2007, followed by fully stocking our distribution channel in the latter half of the third quarter of 2007. Our mobile handheld computer has received favorable reviews in the marketplace and accounted for 6% of our total 2007 revenues. Our overall data collection revenues increased by 16% in 2007 compared to 2006, due in part to our efforts in developing our Vertical Industry Partners Program to encourage VARS, integrators and developers to develop business applications, which resulted in the increased availability and deployment of software applications by businesses. Offsetting the increased revenues related to these accomplishments in 2007, were overall declines in sales of our Bluetooth modules due to competitive factors that existed in the marketplace in the beginning of 2007, and continued declines in our legacy products including our Ethernet plug-in products, our wireless plug-in products, and our serial products, as these technologies are being built-in by manufacturers or replaced with newer technologies.

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(Table of Contents)

Total operating expenses in 2007 increased by one percent compared to total operating expenses in 2006. Our largest operating cost, over 50 percent of our operating costs in 2007, was the cost of our personnel. We adopted SFAS 123R beginning January 1, 2006 and began recognizing stock-based compensation expense, which added \$ 1.0 million and \$1.2 million of personnel expense in fiscal 2007 and 2006, respectively. Additional increases in personnel costs in 2007 were primarily due to the additions of key sales personnel, including the addition of our Senior Vice President of Sales & Marketing in the second quarter, as we staffed the sales team to promote and sell our line of mobile handheld computers, and additions of engineering personnel to staff in-house technical expertise for our development programs, which reduced our reliance on outside technical service providers. Most of our senior employees have a variable portion of their compensation based on achieving financial and operating goals and objectives. In 2007, our revenues were below our financial goals, which reduced the total variable personnel compensation we paid, partially offsetting

other increases in personnel expenses. Total personnel costs, including the costs of personnel in operations that are charged to cost of sales, increased by 9 percent in 2007 over 2006. Advertising and promotional expense in 2007 declined to 5 percent of total operating expenses, compared to 9 percent in 2006.

Our balance sheet at December 31, 2007 included \$5.0 million in cash, a current ratio (current assets divided by current liabilities) of 1.3 to 1.0, and no material long-term debt. Our cash balances at year-end included a net increase of \$0.4 million in amounts drawn on our bank lines of credit and \$0.4 million from the net balance outstanding on a term loan advanced in June of 2007. We used \$1.1 million in cash from operations in 2007, including \$0.3 million in cash provided from working capital changes, primarily from increases in deferred income and accrued payroll. We managed our inventory levels in 2007, holding overall increases at December 31, 2007 to less than \$0.1 million from the preceding year-end. Additionally, warrants and options exercised in 2007 resulted in a source of cash of \$0.1 million.

We have an experienced management team with five of our eight officers having served the Company for more than thirteen years. We believe we comply with the standards for good corporate governance. In the three years ended December 31, 2007, we were subject to the requirement of an audit of our internal controls over financial reporting for fiscal year 2005 only, for which we received an unqualified opinion on our internal controls. In 2007 and 2006 we were not subject to this requirement, but continue to perform internal control testing to monitor and assess the effectiveness of the Company's internal control over financial reporting, and we report our assessment in Item 9A(T). Controls and Procedures.

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(Table of Contents)

## Revenues

Our revenues have been classified into four broad product families for the years ended December 31, 2007, 2006, and 2005, and are presented in the following table:

<i>(revenues in thousands)</i>	Years ended December 31,						Increase (Decrease) in years	
	2007		2006*		2005*		2007 vs. 2006	2007 vs. 2006
Product family:	\$'s	%'s	\$'s	%'s	\$'s	%'s		
Mobile handheld computer products:	\$ 1,342	6%	\$ ---	---%	\$ ---	---%	n/a	n/a
Mobile peripheral products:								
Data collection	11,989	50%	10,371	42%	9,695	38%	16%	7%
Connectivity	2,470	10%	4,095	16%	5,430	22%	(40%)	(25%)
OEM embedded products	6,541	27%	7,983	32%	6,639	27%	(18%)	20%
	&nbsp; 1,776&nbsp;	7%	&nbsp; 2,532&nbsp;	10%	&nbsp; 3,270&nbsp;	13%	(30%)	(23%)



## Serial interface products

Total	\$	24,118	100%	\$	24,981	100%	\$	25,034	100%	(3%)	---
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\* For the 2006 and 2005 years presented above, revenues related to our Wireless LAN plug-in cards and Bluetooth plug-in cards, which historically had been included in our connectivity products category, have been reclassified within the OEM embedded products to be consistent with the classification of these revenues in 2007. See the discussion that follows on connectivity product revenues and OEM embedded product revenues for additional information.

Beginning in 2007 we added a mobile handheld computer to our product lines which is classified in the *mobile handheld computer products* category. Shipments of our first mobile handheld computer, the SoMo 650, to customers in our distribution channel began as planned in the second quarter of 2007. In the third quarter of 2007 we completed our objectives of ramping up production and fully stocking our distribution channel to enable widespread customer evaluation and qualification of the product to commence. Revenues related to our first mobile handheld computer represented approximately 6 percent our total revenues for fiscal 2007. The effect of stocking our distribution channel resulted in increases in deferred income on shipments to distributors at December 31, 2007, compared to a year ago.

Our *data collection product* revenues in 2007 increased by \$1.6 million from data collection revenues in 2006. Record quarterly data collection revenues in the first half of 2007 were slowed in the second half of 2007 due in part to an announcement by a major handheld computer manufacturer of new handheld models for the consumer market. Such announcements typically slow customer deployments of our peripheral products because of the time needed by customers to evaluate or adopt new handheld models. Overall growth in 2007 in our data collections revenues compared to 2006 was due to both our efforts in developing programs such as our Vertical Industry Partners Program, and a recovery in the first half of 2007 from adverse market conditions that existed in 2006. We are dependent upon VARS, integrators and developers of third party software applications to supply vertical application software that uses the computers and peripheral products that we manufacture or support, and we have developed programs such as our Vertical Industry Partners Program to encourage VARS, integrators and developers of such applications to do so. Overall growth in data collection revenues for 2007 reflects in part the growth in availability and deployment of software applications by businesses. The primary contributor to growth in data collection product revenues in 2007 was our Cordless Hand Scanner product which had revenue increases of \$0.8 million. Additional increases in data collection revenues in 2007 were \$0.5 million from increased sales of our primary data collection product, our CompactFlash In-Hand Scan card, \$0.3 million from increased sales of our Cordless Ring Scanner, and increased sales of our SDIO In-Hand Scan card, partially offset by declines in revenues of discontinued scanning products.

(Table of Contents)

Data collection product revenues in 2006 increased by \$0.7 million from data collection revenues in 2005. Revenue increases in 2006 of \$0.8 million in sales of our Cordless Hand Scanner, and increases of \$0.4 million in sales of our Cordless Ring Scanner which began shipping in the fourth quarter of 2005, were partially offset by declines in sales of our SDIO In-Hand Scan card, declines in our In-Hand Scan Imager card, and declines in our primary scanning product, the CompactFlash In-Hand Scan card. Data collection revenues in 2006 were slowed by the introduction of an operating system upgrade, Windows Mobile 5.0, announced in September 2005 by the major handheld manufacturers, which slowed customer deployments throughout 2006, as third-party applications were modified and tested with the operating system. Transition to lead-free products in the second quarter of 2006 to comply with the Reduction of Hazardous Substances (RoHS) rules implemented in Europe and around the world, limited the availability of units by the major handheld manufacturers until late in the second quarter of 2006. Third quarter of 2006 was adversely affected by a marked reduction in deployments by a key North American channel partner.

Our *connectivity product* revenues for the three years presented in the above table consist of Ethernet plug-in cards, Modems, and accessory products including our Mobile Power Pack. Beginning with the first quarter of 2007, sales of our Wireless LAN plug-in cards and Bluetooth plug-in cards, which have historically been included in our connectivity products category, are now included within the OEM embedded products family. This reclassification reflects that the majority of our Wireless LAN plug-in card and Bluetooth plug-in card revenues are being driven in 2007 by customers of our OEM embedded products family, whereas sales in 2006 and 2005 were driven by non-OEM customers. For comparative purposes in the table previously presented, revenues related to our Wireless LAN plug-in cards and Bluetooth plug-in cards, which were formerly classified within the connectivity products category in the years 2006 and 2005, have been reclassified within the OEM product revenue family for these years.

Connectivity revenue declines in 2007 of \$0.8 million in sales of our Modem plug-in products, and \$0.5 million in sales of our Ethernet plug-in products were due to reduced corporate deployments of these wired connection solutions. Additional declines in 2007 were from reduced sales of our accessory products including our Mobile Power Pack, and our Cordless GPS receiver with navigation kit which was discontinued in 2006. Revenue declines in 2006 were from declines of \$0.4 million in reduced sales of our Modem plug-in cards and Ethernet plug-in cards, and declines of \$0.8 million from reduced sales of our discontinued Cordless GPS receiver product. Revenues from our accessory products, including our Mobile Power Pack, were flat in 2006 compared to 2005. Connectivity revenues in 2006 were slowed by the introduction of an operating system upgrade, Windows Mobile 5.0, announced in September 2005 by the major handheld manufacturers, which slowed customer deployments in 2006 as third-party applications were modified and tested with the operating system. Transition to lead-free products in the second quarter of 2006 to comply with the Reduction of Hazardous Substances (RoHS) rules implemented in Europe and around the world, limited the availability of units by the major handheld manufacturers until late in the second quarter of 2006. Third quarter of 2006 was adversely affected by a marked reduction in handheld computer deployments by a key North American channel partner.

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(Table of Contents)

Our *OEM embedded product* revenues related to our Bluetooth modules declined by \$0.4 million in 2007 from 2006. Overall decreases in Bluetooth module revenues were due to lower sales, reflecting overall increased competition our module customers experienced in the industrial ruggedized market segment in 2007 compared to 2006. Beginning in the fourth quarter of 2006, our customers in the industrial ruggedized market segment experienced pronounced increased competition due to aggressive price discounting by a major competitor, a trend which also adversely affected our Bluetooth module revenues in the first quarter 2007, but improved steadily in the following second, third, and fourth quarters of 2007. Revenue growth in 2006 of \$1.9 million from sales of our Bluetooth modules was due to increased manufacturing volumes of industrial ruggedized handhelds by our customers during the first three quarters of 2006. In the fourth quarter of 2006 sales levels of our Bluetooth modules declined significantly due to increased competition our customers experienced in the industrial ruggedized market segment during the fourth quarter.

In 2007, all sales related to our Wireless LAN plug-in cards and Bluetooth plug-in cards, the majority of which have historically been included in our connectivity products family, are now included in the revenues of the OEM embedded products family. This reflects that the majority of our Wireless LAN plug-in card and Bluetooth plug-in card revenues in 2007 are being driven by customers within our OEM embedded products group, whereas sales of these products in 2006 and 2005 were driven by non-OEM customers. Revenues related to Wireless LAN plug-in cards and Bluetooth plug-in cards declined by \$1.0 million in 2007 compared to total revenues of these products in 2006, primarily due to these wireless technologies being already built-in by handheld computer manufacturers. Total revenues related to Wireless LAN plug-in cards and Bluetooth plug-in cards in 2006 declined by \$0.6 million. Revenues related to these products in 2006 were slowed by the introduction of an operating system upgrade, Windows Mobile 5.0, announced in September 2005 by the major handheld manufacturers, which slowed customer deployments

in 2006 as third-party applications were modified and tested with the operating system. Transition to lead-free products in the second quarter of 2006 to comply with the Reduction of Hazardous Substances (RoHS) rules implemented in Europe and around the world, limited the availability of units by the major handheld manufacturers until late in the second quarter of 2006. Third quarter of 2006 was adversely affected by a marked reduction in handheld computer deployments by a key North American channel partner.

Our *serial interface product* revenues declined in 2007 by \$0.8 million from revenues in 2006, and in 2006 by \$0.7 million from 2005. Serial interface product revenue declines of \$0.6 million in 2007 and \$0.7 million in 2006 were due to reduced sales of our standard serial PC card products. Our standard peripheral connection cards are primarily sold to connect peripheral devices or other electronic equipment to notebook computers. Additional revenue declines in 2007 and 2006 were from lower sales of our CompactFlash card products compared to 2005. Additional further declines in 2006 were from lower sales of our cordless Bluetooth serial adapter compared to 2005. Overall serial product revenues have declined in the periods presented, continuing a trend reflecting the gradual replacement of serial technology with USB and other newer connection technologies.

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(Table of Contents)

**Gross Margins**

Gross margins for 2007 were 49 percent of revenues compared to gross margins of 49 percent in 2006, and 50 percent in 2005. Margins in 2007 reflect overall margin improvements in data collection products offset by lower initial margins on our new mobile handheld computer which began shipping late in the second quarter of 2007. Initial margins on our mobile handheld computer product are below our average product margins. Margin reductions in 2006 were due to a product mix reflecting growth in products with lower than average margins and reductions in products with higher than average margins. Additional impacts on margins in 2006 are related to higher accruals for inventory reserves compared to 2005, reflecting estimates for excess non-RoHS compliant inventories. We generally price our products as a markup from our cost, and we offer discount pricing for higher volume purchases. Our average target gross margin historically has been 50 percent, and we expect shipments of our mobile handheld computer in the coming quarters to reduce our overall gross margin percentage by up to a few percentage points from historical margins depending on volumes shipped.

**Research and Development Expense**

Research and development expense in 2007 was \$5.0 million, a decrease of 3 percent from research and development expense in 2006 of \$5.1 million. Research and development expense in 2006 increased by 46 percent from research and development expense in 2005 of \$3.5 million. Reductions in 2007 totaling \$0.4 million were from reduced equipment costs and consulting and professional fees, and were partially offset by increases in personnel costs as we staffed in-house expertise for technical skills formally sourced to outside consulting and professional service providers. Increases in 2006 of \$0.6 million were from higher personnel costs of which approximately half was related to the recognition of stock-based compensation expense resulting from the adoption and implementation of SFAS 123R beginning January 1, 2006. Additional increases in 2006 were from increased equipment costs, outside services, and consulting and professional fees reflecting increased development activities, of which \$0.3 million was attributable to the initial costs of the development of our mobile handheld computer, for which we incurred comparable costs in 2007, primarily in the first quarter, from the conclusion of the development of this new product.

**Sales and Marketing Expense**

Sales and marketing expense in 2007 was \$7.4 million, an increase of 3 percent compared to sales and marketing expense in 2006 of \$7.1 million. Sales and marketing expense in 2006 increased by 8 percent compared to sales and marketing expense in 2005 of \$6.6 million. Increases in personnel costs of \$0.5 million in 2007 were due to the additions of key personnel beginning in the second quarter of 2007, including our Senior Vice President of Sales & Marketing, as we staffed the sales team to promote and sell our new mobile handheld computer which began shipping late in the second quarter of 2007. Additional increases were from increased travel related to the additions of staff members to the sales team. Partially offsetting these increases were reductions of \$0.5 million from lower levels of advertising and promotional expenses. In 2006, increases in personnel costs of \$0.5 million were primarily from stock-based compensation expense resulting from the adoption and implementation of SFAS 123R beginning January 1, 2006. Slight increases in equipment costs and consulting and professional fees, were partially offset by reductions in outside services and advertising and promotion.

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(Table of Contents)

**General and Administrative Expense**

General and administrative expense in 2007 was \$2.7 million, an increase of 2 percent compared to general and administrative expense in 2006. General and administrative expense in 2006 increased by 6 percent compared to general and administrative expense in 2005 of \$2.5 million. Increases in 2007 were primarily from higher equipment expense as we began to depreciate the costs of capitalized leasehold improvements and furniture and fixtures related to our new corporate headquarters as of January 2007, and higher overall occupancy related costs compared to the prior year. Increases in personnel costs in 2006 of \$0.4 million were primarily from stock-based compensation expense recognized in 2006 resulting from the adoption and implementation of SFAS 123R beginning January 1, 2006. Partially offsetting these increases were reduced professional fees in 2006 related to Sarbanes-Oxley compliance requirements incurred in 2005, and reduced business insurance costs compared to 2005.

**Amortization of Intangibles**

In July 2004 we acquired a patent which covers the design and functioning of plug-in bar code scanners, bar code imagers, and radio frequency identification products. The patent was purchased for \$600,000 and has been capitalized as an intangible asset. The patent is being amortized on a straight line basis over a ten-year period. Intangible assets of \$571,000 remaining from a prior acquisition in 2000 consist of developed software and technology with estimated lives at the time of acquisition of 8.5 years. At December 31, 2004, a licensing agreement with a book value of \$38,000 was reclassified as an intangible asset and was amortized over its remaining life of three years ending in December 2007. During the first quarter of 2002, we acquired intangible assets in conjunction with the acquisition of Nokia's CompactFlash Bluetooth Card business and related product line technology valued at \$980,000. Estimated useful lives of these acquired assets at the time of acquisition ranged from one to three years. All components of the acquired Nokia intangibles were fully amortized by the end of the first quarter in fiscal 2005. Total amortization charges in 2007 for all acquired intangibles were \$135,000, compared to \$140,000 in 2006, and \$203,000 in 2005. The lower annual amortization charges are due to components of intangible property becoming fully amortized.

**Interest Income and Other, and Interest Expense**

Interest income reflects interest earned on cash balances. Interest income was \$114,000 in 2007, \$175,000 in 2006, and \$92,000 in 2005. Lower interest income in 2007 compared to 2006 reflects lower average cash balances in 2007 partially offset by higher rates of return. Lower levels of cash in 2007 compared to 2006 are primarily the result of an increased use of cash in financing greater quarterly operating losses in 2007 compared to 2006. Higher levels of

interest income in 2006 compared to 2005 reflect higher average levels of cash on hand in 2006 combined with higher rates of return. Higher levels of cash on hand in 2006 compared to 2005 were primarily from the exercise of Series E and Series F warrants totaling \$0.6 million.

Interest expense was \$34,000 in 2007, \$8,000 in 2006, and \$5,000 in 2005. Interest expense is related to interest on equipment lease financing obligations, and interest on amounts drawn on our bank lines of credit and term loan. We used our bank lines of credit only at the end of each quarter in each of the years presented. The term loan was advanced at the end of the second quarter of 2007 and is being repaid in 36 monthly installments which began in July of 2007. Higher interest expense in 2007 as compared to 2006 was due to interest on our term loan and higher interest rates on our lines of credit in 2007 compared to 2006. Higher interest expense in 2006 as compared to 2005 was due to higher interest rates on our lines of credit in 2006 compared to 2005.

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(Table of Contents)

**Income Taxes**

We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under SFAS 109, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. We record a valuation allowance against deferred tax assets when it is more likely than not that such assets will not be realized. We have not generated taxable income in any periods in any jurisdiction, foreign or domestic. The Company has maintained a full valuation allowance for all deferred tax assets. There can be no assurance that the deferred tax assets subject to the valuation allowance will be realized.

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" ("FIN 48"), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of January 1, 2007, as required. There were no adjustments to the financial statements as a result of the adoption of FIN 48. See Note 11 - Income Taxes, for additional information.

**Preferred Stock Dividends**

Preferred stock dividends in the first nine months of 2006 reflect dividends of \$10,700 accrued at the rate of 8% per annum on Series F Preferred Stock through the date of mandatory conversion in the first quarter 2006. Series F Preferred Stock was originally issued in March 2003. Series F dividends were payable quarterly in cash or in common stock, at the option of the Company. Dividends in the first quarter 2006 through the date of conversion were paid prior to the end of the first quarter. On March 21, 2006 the outstanding shares of Series F Preferred Stock automatically converted into common stock resulting in the issuance of 823,300 shares of common stock.

Preferred stock dividends of \$11,000 in 2006, and \$48,000 in 2005, reflect dividends accrued at the rate of 8% per annum on Series F Preferred Stock issued in March 2003. Series F dividends were payable quarterly in cash or in common stock, at the option of the Company. Dividends in 2006 reflect dividends up through the date of mandatory conversion of Series F Preferred Stock in the first quarter 2006, and were paid prior to the end of the first quarter. On

March 21, 2006 the outstanding shares of Series F Preferred Stock automatically converted into common stock resulting in the issuance of 823,300 shares of common stock. Dividends in 2005 for Series F Preferred Stock were paid in cash subsequent to the end of each of the quarters.

(Table of Contents)

**Quarterly Results of Operations**

The following table sets forth summary quarterly statements of operations data for each of the quarters in 2006 and 2007. This unaudited quarterly information has been prepared on the same basis as the annual information presented elsewhere herein, and, in our opinion, includes all adjustments (consisting only of normal recurring entries) necessary for a fair presentation of the information for the quarters presented. The operating results for any quarter are not necessarily indicative of results for any future period.

	Quarter Ended							
	Mar 31,	Jun 30,	Sep 30,	Dec 31,	Mar 31,	Jun 30,	Sep 30,	Dec 31,
	<u>2006</u>	<u>2006</u>	<u>2006</u>	<u>2006</u>	<u>2007</u>	<u>2007</u>	<u>2007</u>	<u>2007</u>
Revenue	\$ 6,759	\$ 6,855	\$ 5,974	\$ 5,393	\$ 5,548	\$ 6,300	\$ 5,424	\$ 6,855
Cost of sales	&nbsp; 3,385	&nbsp; 3,454	&nbsp; 3,151	&nbsp; 2,800	&nbsp; 2,763	&nbsp; 3,216	&nbsp; 2,808	&nbsp; 3,454
Profit	3,374	3,401	2,823	2,593	2,785	3,084	2,616	3,401
Operating expenses	1,137	1,379	1,239	1,383	1,427	1,162	1,123	1,239
Depreciation and amortization	1,762	1,841	1,839	1,703	1,759	1,970	1,799	1,839
Other	842	641	594	620	857	682	566	620
Income before taxes	&nbsp; 36	&nbsp; 36	&nbsp; 35	&nbsp; 33	&nbsp; 34	&nbsp; 34	&nbsp; 34	&nbsp; 33
Income tax	3,777	3,897	3,707	3,739	4,077	3,848	3,522	3,897
Net income	34	48	46	39	34	27	16	34
Income tax expense	&nbsp; ---	&nbsp; ---	&nbsp; ---	&nbsp; (150)	&nbsp; 8	&nbsp; 8	&nbsp; 8	&nbsp; 8
Net income after tax	(369)	(448)	(838)	(1,257)	(1,266)	(745)	(898)	(448)
Net loss	&nbsp; (11)	&nbsp; ---	&nbsp; ---	&nbsp; ---	&nbsp; ---	&nbsp; ---	&nbsp; ---	&nbsp; ---

ers	\$	(380)	\$	(448)	\$	(838)	\$	(1,257)	\$	(1,266)	\$	(745)	\$	(898)	\$	(4)
ers	\$	(0.01)	\$	(0.01)	\$	(0.03)	\$	(0.04)	\$	(0.04)	\$	(0.02)	\$	(0.03)	\$	(0.)

We have experienced significant quarterly fluctuations in operating results, and we anticipate such fluctuations to continue in the future. We generally ship orders as received and therefore quarterly revenue and operating results depend on the volume and timing of orders received during the quarter, which are difficult to forecast. Historically, we have recognized a substantial portion of our revenue in the last month of the quarter. Operating results may also fluctuate due to factors such as the demand for our products, the size and timing of customer orders, the introduction of new products and product enhancements by us or our competitors, product mix, timing of software enhancements, changes in the level of operating expenses, and competitive conditions in the industry. Because our staffing and other operating expenses are based on anticipated revenue, a substantial portion of which is not typically generated until the end of each quarter, delays in the receipt of orders can cause significant variations in operating results from quarter to quarter.

### Liquidity and Capital Resources

We were unprofitable in each of the quarters of fiscal 2007 and 2006. We were profitable in two quarters in 2005, but unprofitable for fiscal year 2005. We may continue to be unprofitable in the foreseeable future. Historically we have financed our operations through the sale of equity securities, equipment financing, and revolving bank lines of credit. Since our inception we have raised approximately \$51 million in equity capital to fund our operations.

### (Table of Contents)

Cash used in operating activities was \$1.1 million in 2007 compared to \$0.4 million used in operating activities in 2006, and cash provided by operating activities of \$2.2 million in 2005. Cash used in 2007 from our net loss adjusted for non-cash items was \$1.4 million, compared to cash used in 2006 of \$0.8 million from our net loss adjusted for non-cash items, and cash provided of \$0.5 million in 2005 from our net loss adjusted for non-cash items. Adjustments for non-cash items consisting of depreciation and amortization, amortization of intangibles, gains and losses on foreign currency transactions, changes in deferred rent, deferred tax expense, and stock-based compensation expense, totaled \$1.9 million in 2007, compared to \$2.1 million in 2006, and \$0.7 million in 2005. Reductions in non-cash items in 2007 were primarily from lower stock compensation expense compared to 2006. Increases in non-cash items in 2006 compared to 2005 were primarily from stock-based compensation expense due to the adoption of FAS 123R on January 1, 2006. Changes in working capital balances resulted in a source of cash of \$0.3 million in 2007, \$0.4 million in 2006, and \$1.7 million in 2005. Changes in working capital balances in 2007 were primarily from increases in deferred income on shipments to distributors due to increased levels of inventory in our channel primarily from distributors stocking our new mobile handheld computer which we began shipping in June 2007, and increases in accrued payroll, partially offset by increases in inventory and prepaid royalties related to our new mobile handheld computer. Changes in working capital balances in 2006 were primarily from increases in deferred income on shipments to distributors due to increased inventory levels in our distribution channel, and reductions in accounts receivables due to lower shipments in the fourth quarter, partially offset by decreases accounts payables and increases

in inventory and other assets. Changes in working capital balances in 2005 were primarily from decreases in receivables due to early collections from key distributors, and reductions in levels of inventory, partially offset by increases in prepaid assets and decreases in payables.

Cash used in investing activities was \$1.0 million in 2007, \$0.8 million in 2006, and \$0.6 million in 2005. Increased investing activities in 2007 reflects the costs of leasehold improvements related to our new corporate headquarters incurred primarily in the first quarter of 2007. Remaining investing activities in each of the periods presented reflects the costs of new computer hardware and software, and tooling costs.

Cash provided by financing activities was \$ 0.9 million in 2007 compared to \$0.5 million in 2006, and cash used in financing activities of \$0.6 million in 2005. Financing activities in 2007 consisted primarily of a net increase of \$0.4 million in the amounts drawn on our bank lines of credit, \$0.4 million from a term loan advance in June of 2007 net of repayments, and proceeds from the exercise of stock options. At the end of 2007 we drew \$2.6 million in cash against our bank credit line, which we repaid in January 2008. Financing activities in 2006 consisted primarily of proceeds totaling \$0.6 million from the exercise of warrants and stock options, partially offset by a net decrease in the amounts drawn on our bank lines of credit, and the final dividend payments on Series F Preferred Stock. At the end of 2006 we drew \$2.2 million in cash against our bank credit line, which we repaid in January 2007. Financing activities in 2005 consist primarily of a net decrease of \$0.6 million in the amounts drawn on our bank lines of credit. Payments of cash dividends and payments on capital leases totaling \$0.1 million were offset by proceeds from the exercise of stock options. At the end of 2005 we drew \$2.3 million in cash against our bank credit line, which we repaid in January 2006.

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(Table of Contents)

Our cash balances at December 31, 2007 were \$5.0 million, including cash of \$2.6 million drawn against our bank line of credit and a net balance of \$0.4 million from a term loan advance which is being repaid monthly over three years beginning in July of 2007. We concluded the development and related expense for our first mobile handheld computer primarily in the first quarter of 2007 and began shipping initial units to our customers in June 2007, followed by volume shipments to stock our distribution channel in mid September. In May of 2007, we extended our bank line of credit agreement which will now expire on March 3, 2009. We have warrants outstanding from our private placement financings and outstanding employee stock options that, if exercised, would further increase our cash and equity balances. We believe our existing cash, plus our ability to reduce costs, and our bank line and term loan will be sufficient to meet our funding requirements at least through December 31, 2008. If we can return to profitability and revenue growth, we anticipate requirements for cash will include funding of higher receivable and inventory balances, and increasing expenses, including more employees to support our growth and increases in salaries, benefits, and related support costs for employees. If we cannot return to profitability, we will not be able to support our operations from positive cash flows, and we would use our existing cash to support operating losses. If we are unable to secure the necessary capital to replace that cash, we may need to suspend some or all of our current operations. Should the need arise, we cannot assure you that additional capital will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. Although we do not anticipate the need to raise additional capital at this time to fund our operations, we may raise additional capital if market conditions are appropriate.

Our contractual obligations at December 31, 2007 are outlined in the table below:

&nbsp;	Total	Payments Due by Period			
		Less than 1 year	1 to 3 years	4 to 5 years	More than 5 years



<b>Contractual Obligations</b>										
Capital leases	\$	63,800	\$	37,100	\$	25,600	\$	1,100	\$	---
Operating leases		1,700,800		357,500		751,000		592,300		---
Term loan, principle and interest	&nbsp;	427,000	&nbsp;	160,400	&nbsp;	266,600	&nbsp;	---	&nbsp;	---
Unconditional purchase obligations with contract manufacturers	&nbsp;	4,093,500	&nbsp;	3,985,500	&nbsp;	108,000	&nbsp;	---	&nbsp;	---
Total contractual cash obligations	\$	6,285,100	\$	4,540,500	\$	1,151,200	\$	593,400	\$	---

### Off-Balance Sheet Arrangements

As of December 31, 2007, we have no off-balance sheet arrangements as defined in Item 303 of Regulation S-K.

### (Table of Contents)

### Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" ("FIN 48"), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of January 1, 2007, as required. There were no adjustments to the financial statements as a result of the adoption of FIN 48. See Note 11 - Income Taxes, for additional information.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years and interim periods beginning after November 15, 2007. The Company is currently evaluating whether the provisions of SFAS No. 157 will result in a change to its fair value measurements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"), which permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. SFAS 159 is effective for the Company beginning in the first quarter of fiscal 2008. The Company has not yet determined the impact, if any, of SFAS 159 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements-an amendment of Accounting Research Bulletin No. 51" ("SFAS 160"), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of

consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company has not yet determined the impact, if any, of the adoption of SFAS 160 on our consolidated financial statements.

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(Table of Contents)

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to invested cash. Our cash is invested in short-term money market investments backed by U.S. Treasury notes and other investments that mature within one year and whose principal is not subject to market rate fluctuations. Accordingly, interest rate declines would adversely affect our interest income but would not affect the carrying value of our cash investments. Based on a sensitivity analysis of our cash investments during the quarter ended December 31, 2007, a decline of 1% in interest rates would reduce our quarterly interest income by approximately \$5,900.

Our bank credit line facilities of up to \$4.0 million have variable interest rates based upon the lender's index rate plus 0.5% for both the domestic line (up to \$2.5 million) and the international line (up to \$1.5 million). Accordingly, interest rate increases would increase our interest expense on outstanding credit line balances. We utilized our credit line facility only at the end of each quarter in 2007 and 2006, and therefore did not subject ourselves to interest rate exposure. Based on a sensitivity analysis, an increase of 1% in the interest rate would increase our borrowing costs by \$10,000 for each \$1 million of borrowings, if outstanding for the entire year, against our bank credit facility or a maximum of \$40,000 if we utilized our entire credit line.

**Foreign Currency Risk**

A substantial majority of our revenue, expense and purchasing activities are transacted in U.S. dollars. However, we require our European distributors to purchase our products in Euros, we pay the expenses of our European employees in Euros and British pounds, and we may enter into selected future purchase commitments with foreign suppliers that may be paid in the local currency of the supplier. We hedge a significant portion of our European receivables balance denominated in Euros to reduce the foreign currency risk associated with these assets, and we have not been subject to significant losses from material foreign currency fluctuations. Based on a sensitivity analysis of our net foreign currency denominated assets and subsidiary expenses at the beginning, during and at the end of the quarter ended December 31, 2007, an adverse change of 10% in exchange rates would result in a decrease in our net income for the fourth quarter of approximately \$80,100, if left unprotected. For the fourth quarter of 2007 the total net adjustment for the effects of changes in foreign currency on cash balances, collections, payables, and derivatives was a net loss of \$5,700. We will continue to monitor, assess, and mitigate through hedging activities, the risk associated with these exposures.



(Table of Contents)

**SOCKET COMMUNICATIONS, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2007	2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 4,963,359	\$ 6,104,277
Accounts receivable, net of allowance for doubtful accounts of \$118,651 at December 31, 2007 and 2006	2,614,872	2,699,218
Inventories	2,438,033	2,350,284
Prepaid expenses and other current assets	&nbsp; 282,867	&nbsp; 193,196
<b>Total current assets</b>	<b>&amp;nbsp; 10,299,131</b>	<b>&amp;nbsp; 11,346,975</b>
&nbsp;		
Property and equipment:		
Machinery and office equipment	2,391,991	1,790,053
Computer equipment	&nbsp; 1,125,875	&nbsp; 1,021,720
&nbsp;	&nbsp; 3,517,866	&nbsp; 2,811,773
Accumulated depreciation	&nbsp; (2,373,409)	&nbsp; (2,069,596)
Property and equipment, net	&nbsp; 1,144,457	&nbsp; 742,177
&nbsp;		
Intangible assets, net	473,934	608,491
Goodwill	9,797,946	9,797,946
Other assets	&nbsp; 258,445	&nbsp; 291,778
<b>Total assets</b>	<b>\$ 21,973,912</b>	<b>\$ 22,787,367</b>
&nbsp;		
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,352,287	\$ 2,368,388
Accrued expenses	76,881	72,016
Accrued payroll and related expenses	852,185	751,007
Bank line of credit	2,622,009	2,213,261
Deferred income on shipments to distributors	1,744,560	1,472,781
Term loan - short term portion	160,439	---
Current portion of capital leases and deferred rent	&nbsp; 42,964	&nbsp; 8,372
<b>Total current liabilities</b>	<b>&amp;nbsp; 7,851,325</b>	<b>&amp;nbsp; 6,885,825</b>
&nbsp;		
Long term portion of capital leases and deferred rent	139,743	---
Term loan - long term portion	266,543	---
Deferred income taxes	&nbsp; 182,322	&nbsp; 150,379
<b>Total liabilities</b>	<b>&amp;nbsp; 8,439,933</b>	<b>&amp;nbsp; 7,036,204</b>
&nbsp;		
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value: Authorized shares 100,000,000,		
Issued and outstanding shares 31,989,617 at December 31, 2007 and 31,851,285 at December 31, 2006	31,990	31,851
Additional paid-in capital	53,654,483	52,531,493
Accumulated deficit	&nbsp; (40,152,494)	&nbsp; (36,812,181)
<b>Total stockholders' equity</b>	<b>&amp;nbsp; 13,533,979</b>	<b>&amp;nbsp; 15,751,163</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 21,973,912</b>	<b>\$ 22,787,367</b>

See accompanying notes.

(Table of Contents)

**SOCKET COMMUNICATIONS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

Years Ended December 31,

	2007	&nbsp;	2006	&nbsp;	2005	&nbsp;
Revenues	\$ 24,118,032		\$ 24,981,455		\$ 25,034,108	
Cost of revenues	&nbsp;12,244,873		&nbsp;12,790,062		&nbsp;12,445,082	
Gross profit	11,873,159		12,191,393		12,589,026	
<b>Operating expenses:</b>						
Research and development	5,004,681		5,136,507		3,510,359	
Sales and marketing	7,380,326		7,144,866		6,590,227	
General and administrative	2,741,644		2,698,051		2,538,981	
Amortization of intangible assets						LOR: #000000; TEXT-ALIGN: left; LINE-HEIGHT: 1.25">Net cash used in investing activities
	&nbsp;134,557		&nbsp;140,446		&nbsp;203,042	- - (189,541)

**Cash Flows**

from

Financing

Activities:

Net

Proceeds

from

general

financing

-

80,000

737,500

Net

Proceeds

(payments)

from

shareholder

/ officers

-

-

(113,947)

Proceeds

from

issuance of

common

stock

-

-

33,586

Net cash

provided by

financing

activities

-

80,000

657,139

Net increase (decrease) in cash	-	-	-
Beginning of period - continuing operations	-	-	-
End of period - continuing operations	\$-	\$ -	\$ -
Cash paid for interest	\$-	\$ -	\$ 24,295
Cash paid for income taxes	\$-	\$ -	\$ -

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

Sector 10, Inc.  
(A DEVELOPMENT STAGE COMPANY)  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - ORGANIZATION AND BUSINESS OPERATIONS

The Company markets the MRU and SRU products and the PLX-3D technology. In 2009, the Company was planning to release the technology and its MRU and SRU products in San Francisco and other cities in the US with the help of the Gage Group and other parties.

In 2009, the outside Manufacturer breached the manufacturing contract. In 2009 and in subsequent years, it was also discovered that the manufacturer and its affiliates had been conducting a technology transfer to other parties.

Litigation is pending regarding these matters in Utah state court

Note 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

The accompanying unaudited consolidated condensed financial statements of Sector 10, Inc. ("Sector 10" or the "Company"), have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and required by Rule 10-01 of Regulation S-X. They do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation, have been included in the accompanying unaudited consolidated financial statements. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the full year.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

It is the Company's policy to invest cash with financial institutions judged to be highly secure. For purposes of the statement of cash flow, the Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Accounts Receivable

The Company extends credit to its customers in the normal course of business. The Company reviews outstanding receivables, and provides for estimated losses through an allowance for doubtful accounts. In evaluating the level of established loss reserves, the Company makes judgments regarding its customers' ability to make required payments, economic events and other factors. As the financial condition of these parties change, circumstances develop or additional information becomes available, adjustments to the allowance for doubtful accounts may be required. The Company has no sales and no receivables outstanding for the fiscal year ended March 31, 2018.





### Inventory

Inventories are valued at the lower of cost and net realizable value. Cost is determined on a first-in, first-out basis.

Due to pending litigation, there was no sales activity and no inventory on hand at the fiscal year ended March 31, 2018. Due to the impact of the extended litigation, the inventory has been recorded at no value as of March 31, 2018.

Therefore, for the fiscal year ended March 31, 2018, all inventory and the related reserve was \$0.

### .Property and Equipment and Depreciation

Property and equipment are carried at historical cost less accumulated depreciation. The cost of maintenance and repairs is charged to income as incurred, whereas significant renewals and betterments are capitalized. The cost and the related accumulated depreciation of assets sold or otherwise retired are eliminated from the accounts and any gain or loss is included in the statement of income.

The Company provides for depreciation of property and equipment principally by use of the straight-line method for financial reporting purposes. Depreciation begins in the month that depreciable assets are placed in service. The only assets currently placed in service are computers and furniture and equipment. Computers and depreciable equipment are estimated to have a useful life of 5 years. Depreciation is computed based on a straight line basis over the estimated useful life. All property and equipment is fully depreciated at the end of the fiscal year end.

### Notes Payable

The Company received funding from outside investors. The Company is currently in litigation and any additional funding (if any) will be used for legal fees. No additional operational funding is expected until at least during the fiscal year ended March 31, 2019.

### Contingencies

We account for loss contingencies in accordance with ASC 450, "Accounting for Contingencies." Accordingly, when management determines that it is probable that an asset has been impaired or a liability has been incurred, we accrue our best estimate of the loss if it can be reasonably estimated. Our legal costs related to litigation are expensed as incurred.

### Income Tax

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss, tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in the tax laws and rates on the date of enactment.

### Loss Per Share

In accordance with ASC 280, "Earnings Per Share," we report basic loss per common share, which excludes the effect of potentially dilutive securities, and diluted loss per common share, which includes the effect of all potentially dilutive securities unless their impact is anti-dilutive.



### Share-Based Compensation

We may, from time to time, issue common stock, stock options or common stock warrants to acquire services or goods from non-employees. Common stock, stock options and common stock warrants issued to persons other than employees or directors are recorded on the basis of their fair value.

### Long Lived Assets

The Company maintains a Long Lived Asset which is reviewed regularly for impairment. In its review for impairment, the Company prepares estimates of future cash flows to assist in the determination of the asset's recoverability. If there is an issue regarding recoverability, an independent valuation will be obtained to determine any required adjustment for impairment. The estimates used in determining for recoverability are updated by the Company on a regular basis to provide guidance for management's quarterly and annual reporting.

### Revenue Recognition

The Company had no sales activity during the current fiscal year ended March 31, 2018. The Company records sales of its products based upon the terms of the contract; when title passes to its customers; and, when collectability is reasonably assured.

### Impact of Recent Accounting Pronouncements

Sector 10 does not expect the adoption of any recently issued accounting pronouncements to have a material impact on its financial condition or results of operations.

### Note 3 – INVENTORY

There were no sales in the year ended March 31, 2018. The inventory reflected on the books was \$0 for the fiscal year ended March 31, 2018.

### Note 4 – NOTES PAYABLE

#### Johnson Financing

Total interest accrued as of March 31, 2018 was \$61,686 of which \$10,394 was accrued during the fiscal year ended March 31, 2018.

#### Dutro Financing:

The contingent reserve - interest includes all interest accrued on the Dutro Company note and all interest accrued after July 1, 2010 for the Vicki Davis and William Dutro note. Interest accrued during the fiscal year ended March 31, 2018 was \$36,225 comprised of Dutro Company - \$18,750, Vick Davis - \$12,600 and William Dutro - \$4,875. Total contingent reserve - interest for the period ended March 31, 2018 is \$297,629 comprised of Dutro Company - \$162,198, Vick Davis - \$97,650 and William Dutro - \$37,781.

#### Employee Agreement:

The financial statements reflect an accrual of interest on unpaid wages and other compensation in the amount of \$1,488,578 of which \$355,218 is accrued during the fiscal year ended March 31, 2018.



## Other Notes

Individuals – short term

An additional individual short term note of \$30,000 was issued in July 2016 to pay for legal fees. Another individual short term note of \$50,000 was issued in December 2016 to pay for legal fees. Both new notes accrue interest at an annual rate of 8%.

Total interest accrued as of March 31, 2018 was \$66,729 of which \$13,520 was accrued during the fiscal year ended March 31, 2018. The current period interest is included as part of other notes interest.

Asher Enterprises, Inc.

The Company entered into multiple financing transactions with Asher Enterprises, Inc. to raise capital for Company operations. Each transaction was structured as a Convertible Debenture due 9 months after the issue accruing interest at an annual rate of 8%

Total interest accrued (without discount amortization) as of March 31, 2018 was \$42,102 of which \$5,200 was accrued during the fiscal year ended March 31, 2018. The current period interest is included as part of other notes interest.

Summary of Interest and Notes Payable

	March 31, 2018	March 31, 2017
<u>Interest expense</u>		
Interest – Johnson	10,394	10,394
Interest – Dutro Group	36,225	36,225
Interest - Employee Group	355,218	302,418
Interest – Other Notes	18,720	15,254
Total interest expense	\$420,557	\$364,291
	March 31, 2018	March 31, 2017
<u>Note Payable Balance</u>		
Edward Johnson – Johnson Financing	\$86,615	\$86,615
Various Individuals – Other Notes	169,000	169,000
Asher Enterprises, Inc. – Other Notes	65,000	65,000
Vicki Davis - Dutro Group	168,000	168,000
William Dutro – Dutro Group	65,000	65,000
Dutro Company – Dutro Group	250,000	250,000
Total Note Payable – short term	\$803,615	\$803,615
Total Note Payable – long term	-	\$-
Total Notes Payable	\$803,615	\$723,615



Debt Maturity Schedule

As of March 31, 2018 the annual maturities for notes payable are scheduled as follows:

<u>Fiscal Year</u>	Amount
March 31, 2018	803,615
March 31, 2019	-
March 31, 2020	-
Total	\$803,615

All interest is due under the terms of the various agreements. However future interest payments will not be made until all pending litigation is resolved and a satisfactory revised payment arrangement is completed by all parties.

Note 5 – EQUITY

During the Fiscal Year ended: March 31, 2017:

No equity transactions occurred in the period ended March 31, 2017

During the Fiscal Year ended: March 31, 2018:

No equity transactions occurred in the period ended March 31, 2018

Note 6 – GOING CONCERN

The Company generated minimal revenues prior to the current fiscal year. No revenues were generated for the fiscal year ended March 31, 2018. This level of revenues is not sufficient for the Company to meet its future obligations.

This factor raises substantial doubt about the Company's ability to continue as a going concern.

The Company is in the midst of the Dutro litigation and other litigation. The litigation has hindered the operation of the Company and have set back the ability to raise capital and develop ongoing business in order to continue forward as a going concern. It is expected that litigation will continue to hinder the ability to continue as a going concern through the end of the fiscal year ended March 31, 2019.

Note 7 - INCOME TAX

Income taxes are accounted for using the asset and liability method. Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Net deferred tax assets /liabilities consist of the following components as of March 31, 2018 and 2017:

	March 31, 2018	March 31, 2017
Deferred tax assets:		
NOL Carryover	\$433,761	\$464,961
Related Party Accruals	2,454,304	2,054,159
Accrued Expenses	1,027,866	951,769
Deferred tax liabilities		
Depreciation	-	-
Valuation allowance	(3,915,931)	(3,470,889)
Net deferred tax asset	\$-	\$-

The income tax provision differs from the amount of income tax determined by applying the U.S. federal and state income tax rate to pretax income from continuing operations for the years ended March 31, 2018 and 2017 due to the following:

	March 31, 2018	March 31, 2017
Book Income	\$(476,241)	\$(475,441)
Depreciation	0	0
Meals & Entertainment	0	0
Stock for Services & Finance	0	0
Related Party Accruals	400,145	351,178
Accrued Expenses	76,097	93,063
Impairment Loss	0	0
Valuation Allowance	(1 )	31,200
	\$-	\$-

At March 31, 2018, the Company had net operating loss carryforwards of approximately \$1,192,200 that may be offset against future taxable income from the year 2019 through 2039. No tax benefit has been reported in the March 31, 2018 financial statements since the potential tax benefit is offset by a valuation allowance of the same amount.

Net operating loss carryforwards for Federal income tax reporting purposes are subject to annual limitations. Should a change in ownership occur, net operating loss carryforwards may be limited as to use in future years.

The Financial Accounting Standards Board ("FASB") has issued ASC 740 for Accounting for Income Taxes that clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. ASC 740 requires a company to determine whether it is more likely than not that a tax position will be sustained upon examination based upon the technical merits of the position. If the more-likely-than-not threshold is met, a company must measure the tax position to determine the amount to recognize in the financial statements. As a result of the implementation of ASC 740, the Company performed a review of its material tax positions in accordance with recognition and measurement standards established by ASC 740.

The Company had no unrecognized tax benefit which would affect the effective tax rate if recognized.



The Company includes interest and penalties arising from the underpayment of income taxes in the consolidated statements of operations in the provision for income taxes. As of March 31, 2018 the Company had no accrued interest or penalties related to uncertain tax positions.

The Company files income tax returns in the U.S. federal jurisdiction and in the states of Delaware, Utah and any other jurisdiction where required. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2015.

## NOTE 8 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash and cash equivalents, payables, and notes payable. The carrying amount of cash and cash equivalents and payables approximates fair value because of the short-term nature of these items. The carrying amount of the notes payable approximates fair value as the individual borrowings bear interest at rates that approximate market interest rates for similar debt instruments.

## Note 9 – SUBSEQUENT EVENTS

The Company has evaluated subsequent events per the requirements of ASC Topic 855 and has determined that the following events should be disclosed.

- Litigation involving Dutro Company, Reality Engineering, William Dutro, Vicki Davis, Lee Allen, Valley Inception, LLC, Incisive Software Corporation and Promixex Corporation continues and is expected to continue for 1) the foreseeable future. The Court has scheduled a hearing for August 22, 2018 to determine if the case will proceed with further discovery and trial. Company Counsel is preparing for dependent depositions. The Company expects a trial date is expected to be set before the end of the fiscal year ended March 31, 2019.
- 2) The impact of the issues surrounding the litigation impact the Company's ability to obtain funding needed to operate the Company according to their strategic plans.
- 3) Federal and State authorities have and will continue to be updated on the litigation issues and proceedings

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

The Company filed and/or will file all reports from the year ended March 31, 2011 and all subsequent period until litigation is resolved with unaudited financial statements which is acceptable for a company trading on the Pink Sheets. When funds are available, the Company will engage their audit firm to conduct an audit of all unaudited period in an effort to move back to the Over the Counter Bulletin Board.

There are no disagreements with the accountants on accounting and/or financial disclosures.

## ITEM 9A. CONTROLS AND PROCEDURES

### Critical Accounting Policies

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls and procedures" in Rule 13a-15(e). The Company's disclosure controls and procedures are designed to provide a reasonable level of assurance of reaching the Company's desired disclosure control objectives. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.



As of the end of the period being reported upon, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the foregoing, our Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There have been no other significant changes in our internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Company completed its evaluation.

Evaluation of Disclosure Controls and Procedures. Our management, with the participation of our President, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. The disclosure controls and procedures as of the end of the period covered by this report were effective such that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) (a) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (ii) accumulated and communicated to our management, including our President, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance, however, that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Management's Annual Report on Internal Control over Financial Reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes of accounting principles generally accepted in the United States. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

Our management, with the participation of the President, evaluated the effectiveness of the Company's internal control over financial reporting as of March 31, 2018. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control — Integrated Framework. The Company experienced issues in gathering all needed information to timely file the annual report for the period ended March 31, 2018. As a result, the report was extended but filed within the time allowed under the extension. Based on this evaluation, our Principal Executive Officer and Principal Financial Officer, concluded that, as of March 31, 2018 our internal control over financial reporting were effective.

Changes in Internal Control over Financial Reporting. There were no changes in the Company's internal controls (b) over financial reporting, that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only Management's report in this annual report.

#### ITEM 9B. OTHER INFORMATION

None

22

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information Regarding Present Directors and Executive Officers

The following table sets forth as of March 31, 2013, the name, age, and position of each executive officer and director and the term of office of each director of the Company.

<u>Name</u>	<u>Age</u>	<u>Title</u>	<u>Director or Officer Since</u>
Pericles DeAvila	48	Chairman of the Board and Acting President, Chief Executive Officer	May 12, 2011
Laurence A. Madison	62	Director and Acting Chief Financial Officer / Secretary / Treasurer	May 12, 2011

The following is the business background of each officer and director:

Pericles (Peric) DeAvila: Chairman of the Board and Acting President, CEO

Pericles DeAvila is the inventor of the SRU-M, and the associated PLX-3DSYSTEM, the first self-contained emergency response systems in the emergency and safety market. He has had years of entrepreneurial experience nationally and internationally. His experience in leading large groups of people was expanded when he continued his construction experience as the commercial/industrial construction manager on large projects in Silicon Valley and in the Seattle area; he is fluent in Portuguese, Italian, French, Spanish, as well as English.

In the development of Sector 10, Mr. DeAvila brought together and leads a seasoned team of experts such as Russell Marriott Jr., who pioneered the first government approved Deferred Compensation 401(K) and PAYSOP plans in the United States; Linda Chandler, former Senior Vice President of Sutro & Company; and Jake Garn, former U.S. Senator, Astronaut and Brigadier General, U.S. Air Force, amongst others. Mr. DeAvila experienced firsthand the power of a natural disaster through an earthquake in the Azores Islands in 1980. He lost a close friend and experienced human devastation and disease and believes that Sector 10 is the fulfillment of an essential need affecting our daily lives.

In 2002, he was the recipient of a Congressional National Leadership Award. He was appointed as special advisor to the Chairman of the Congressional Committee on the Business Advisory Council.

Laurence A. Madison, Director and Acting CFO, Secretary and Treasurer

Mr. Madison has more than 30 years experience in public accounting, tax and financial consulting. He has experience as the Chief Financial Officer in both public and private companies. Madison brings Sector 10 experience and expertise in Sarbanes-Oxley compliance and corporate governance. Prior to joining Sector 10, Mr. Madison worked with a large national internal audit consulting firm where he was responsible for reviewing financial processes and controls for large multi-national public companies to ensure compliance under Sarbanes- Oxley. Mr. Madison worked for over 10 years in "Big Four" accounting firms and for 15 years running his own financial consulting firm where he specialized in providing Chief Financial Officer, tax and financial consulting services to private companies and assisted in raising capital for growth companies. Mr. Madison is licensed in Illinois as a Certified Public Accountant and a member of the AICPA and Illinois CPA Society. He has a Bachelors of Accounting from Purdue University



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Except as indicated below, to the knowledge of management, during the past five years, no present or former director, or executive officer of the Company:

(1) filed a petition under the federal bankruptcy laws or any state insolvency law, nor had a receiver, fiscal agent or similar officer appointed by a court for the business or property of such person, or any partnership in which he was a general partner at or within two years before the time of such filing, or any corporation or business association of which he was an executive officer at or within two years before the time of such filing.

(2) was convicted in a criminal proceeding or named subject of a pending criminal proceeding (excluding traffic violations and other minor defenses);

(3) was the subject of any order, judgment or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction, permanently or temporarily enjoining him from or otherwise limiting, the following activities:

(i) acting as a future commission merchant, introducing broker, commodity trading advisor, commodity pool operator, floor broker, leverage transaction merchant, associated person of any of the foregoing, or as an investment advisor, underwriter, broker or dealer in securities, or as an affiliate person, director or employee of any investment company or engaging in or continuing any conduct or practice in connection with such activity;

(ii) engaging in any type of business practice; or

(iii) engaging in any activity in connection with the purchase or sale of any security or commodity or in connection with any violation of federal or state securities laws or federal commodities laws;

(4) was the subject of any order, judgment, or decree, not subsequently reversed, suspended, or vacated, of any federal or state authority barring, suspending, or otherwise limiting for more than 60 days the right of such person to engage in any activity described above under this Item, or to be associated with persons engaged in any such activity;

(5) was found by a court of competent jurisdiction in a civil action or by the Securities and Exchange Commission to have violated any federal or state securities law, and the judgment in such civil action or finding by the Securities and Exchange Commission has not been subsequently reversed, suspended, or vacated.

(6) was found by a court of competent jurisdiction in a civil action or by the Commodity Futures Trading Commission to have violated any federal commodities law, and the judgment in such civil action or finding by the Commodity Futures Trading Commission has not been subsequently reversed, suspended or vacated.

### ITEM 11. EXECUTIVE COMPENSATION

The following tables set forth certain summary information concerning the compensation paid or accrued for each of the Company's last three completed fiscal years to the Company's or its principal subsidiaries chief executive officer and each of its other executive officers that received compensation in excess of \$100,000 during such period (as determined at March 31, 2018, the end of the Company's last completed fiscal year):

Name	Fiscal Year	Compensation
Peric DeAvila	2018	\$ 339,000
Laurence A. Madison	2018	\$ 321,000
Peric DeAvila	2017	\$ 339,000
Laurence A. Madison	2017	\$ 321,000
Peric DeAvila	2016	\$ 336,000

Laurence A. Madison 2016      \$ 318,000

#### Cash Compensation

On February 26, 2010, the CEO and CFO executed employment agreements with the Company which cover the period through the end of the fiscal year ended March 31, 2016. The agreement also provides terms for continuance after March 31, 2016 on an "at will" basis until a new agreement is set in place.

There was no cash compensation to officers in the fiscal year ended March 31, 2018 and no cash compensation was paid in the year ended March 31, 2016. Unpaid compensation was accrued in the fiscal year ended March 31, 2018 and March 31, 2017. The amount accrued was based on the terms set forth in the employment agreements.

#### Bonuses and Deferred Compensation

The CEO and CFO have executed Employment agreements with the company that covers the period through the end of the fiscal year ended March 31, 2018. Under the agreement, the parties are entitled to a cash bonus and a stock bonus.

In March 2010, the Board authorized a Stock Incentive Plan for the benefit of employees and others who perform services on behalf of the Company. A Form S-8 Registration statement was filed on July 13, 2010 to authorize the issuance of Company options to key officers, directors and consultants. Options were issued under the S-8 in the fiscal year March 31, 2011. No other options have been issued under the plan.

No current deferred compensation programs are established as of March 31, 2018. The Company reserves the right to establish such a plan in the future.



### Compensation Pursuant to Plans.

The CEO and CFO have executed Employment agreements with the company that covers the period through the end of the fiscal year ended March 31, 2016. The agreement also provides terms for continuance after March 31, 2016 on an "at will" basis until a new agreement is set in place.

### Pension Table

The Company reserves the right to establish a Company retirement plan. No such plan exists at the March 31, 2018

### Other Compensation

The CEO and CFO have executed Employment agreements with the company that covers the period through the end of the fiscal year ended March 31, 2018. Under the agreement, the following other provisions

### Welfare, Benefit, Savings and Retirements

Treatment of Unpaid Wages or Other Compensation. Employee shall have the right to interest at an annual rate of 8% for any salary or other compensation that is earned under the employment agreement not paid when earned or approved.

Anti-Dilution. The Company provides Employee with anti-dilution protection for common shares that are issued to other parties after the effective date and during the term of this agreement.

Expenses. During the Employment Period, the Employee shall be provided a Company Credit Card and/or shall be reimbursed for all reasonable expenses incurred by the Employee in accordance with the policies, practices and procedures of the Company. Employee agrees to seek approval for expenses in excess of \$1,000 before committing Company resources.

### Compensation of Directors.

The Company compensates all Directors with the issuance of Company common shares. A total of 50,000 shares are issued for a year of service as a director. As the Company develops and/or new directors are added, the Board may revise the compensation for directors.

### Termination of Employment and Change of Control Arrangement

The CEO and CFO have executed employment agreements that provide minimum base salary, bonuses and other benefits. The agreement continues through the fiscal year ended March 31, 2016. The agreement also provides terms for continuance after March 31, 2016 on an "at will" basis until a new agreement is set in place. If a change in control of the Company occurs, the provisions require immediate vesting in all unpaid benefits under the agreement. The minimum due under such an arrangement for any change in control would be an amount equal to three times the compensation due in the last fiscal year under the agreement. The amount shall be due and payable the day before any transaction resulting in such change of control.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of March 31, 2018 the name and the number of shares of the Company's Common Stock, par value \$.001 per share, held of record or beneficially by each person who held of record, or was known by the Company to own beneficially, more than 5% of the 305,778 issued and outstanding shares of the Company's

Common Stock and 351,728 shares that include issued and outstanding shares plus shares that have been accrued but not issued as of March 31, 2018 (after reflecting the impact of the reverse stock split), and the name and shareholdings of each director and of all officers and directors as a group.

Title of Class	Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percentage of Class
<b>OFFICERS, DIRECTORS AND FIVE PERCENT SHAREHOLDERS</b>			
Common	Peric DeAvila	11,391	(1) 3.72 %
Common	Laurence Madison	10,896	(1) 3.56 %
Common	Sector 10 Holdings, Inc.	151,616	(1) 49.58 %
All officers and Directors as a Group (2) Persons (2)		22,287	7.28 %
Including officer, directors and 5% shareholder		173,903	56.86 %

(1) Anti-dilution agreements were entered into with Sector 10 Holdings, Inc. in November 2009 and officers Peric DeAvila and Laurence Madison in February 2010. The above percentages do not reflect all shares that the anti-dilution provisions provide the shareholders that have been accrued but not issued as of March 31, 2016. Therefore the percentages would be increased by approximately 5% total if such dilution shares were issued.

(2) The shares described above have been adjusted to reflect the impact of the 500-1 reverse stock split effective on February 14, 2012.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS During the Year ended March 31, 2018:**

The Company was involved in litigation during the fiscal year ended March 2018. Any related transactions involved the representation of the Company and its management in the pending litigation. No other related transactions occurred during the fiscal year ended March 31, 2018.

**TRANSACTIONS WITH PROMOTERS**

There have been no transactions between the Company and promoters during the last fiscal year.

**ITEM 14. PRINCIPAL ACCOUNTANTS FEES AND SERVICES -**

	2018	2017
Audit Fees	\$ -	\$ -
Audit and Related Fees	-	-
Tax Fees	-	-
All Other Fees	-	-
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>

(1) Audit fees consist of fees billed for the audit of the Company's consolidated financial statements and review of the interim consolidated financial statements.

ITEM 15. EXHIBITS

- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 INS XBRL Instance Document\*
- 101 SCH XBRL Schema Document\*
- 101 CAL XBRL Calculation Linkbase Document\*
- 101 DEF XBRL Definition Linkbase Document\*
- 101 LAB XBRL Labels Linkbase Document\*
- 101 PRE XBRL Presentation Linkbase Document\*

\* The XBRL related information in Exhibit 101 shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section and shall not be incorporated by reference into any filing or other document pursuant to the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing or document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Sector 10, Inc

Date: June 13, 2018 By /s/ Pericles DeAvila  
Pericles DeAvila,  
Principal Executive Officer

Date: June 13, 2018 By /s/ Laurence A. Madison  
Laurence A. Madison,  
Chief Financial Officer