

**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 fiscal year ended December 31, 2006

OR

**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: 0-31659

**NOVATEL WIRELESS, INC.**

(exact name of registrant as specified in its charter)

**Delaware**  
(State or Other Jurisdiction  
of Incorporation or Organization)

**86-0824673**  
(I.R.S. Employer  
Identification No.)

**9645 Scranton Road, Suite 205**  
**San Diego, California**  
(Address of Principal Executive Offices)

**92121**  
(zip code)

Registrant's telephone number, including area code: (858) 320-8800

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

Securities registered pursuant to Section 12(g) of the Act:  
Common Stock, par value \$.001 per share

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
Large accelerated filer  Accelerated filer  Non-Accelerated filer

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

The aggregate market value of the voting common stock held by non-affiliates of the Registrant, based on the closing price of the Registrant's common stock on June 30, 2006, as reported by The Nasdaq Global Market, was approximately \$225,038,823. For the purposes of this calculation, shares owned by officers, directors (and their affiliates) and 5% or greater stockholders, based on Schedule 13G filings, have been excluded. This exclusion is not intended, nor shall it be deemed, to be an admission that such persons are affiliates of the Registrant. The Registrant does not have any non-voting stock issued or outstanding.

The number of shares of the Registrant's common stock outstanding as of March 2, 2007 was 30,253,896.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive proxy statement for the 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A are incorporated by reference into Part III of this Form 10-K to the extent stated herein.

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## **Forward-Looking Statements**

This report contains forward-looking statements based on our current expectations, assumptions, estimates and projections about Novatel Wireless and our industry. These forward-looking statements include, but are not limited to, statements regarding: future demand for access to wireless data and factors affecting that demand; the future growth of wireless wide area networking and factors affecting that growth; changes in commercially adopted wireless transmission standards and technologies; growth in 3G infrastructure spending; the sufficiency of our capital resources; the effect of changes in accounting standards and in aspects of our critical accounting policies; the utilization of our net operating loss carryforwards; and our general business and strategy, including plans and expectations relating to technology, product development and introduction, strategic relationships, customers, manufacturing, service activities and international expansion. The words “may,” “estimate,” “anticipate,” “believe,” “expect,” “intend,” “plan,” “project,” “will” and similar words and phrases indicating future results are also intended to identify forward-looking statements.

Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those anticipated in such forward-looking statements as of the date of this report. You should carefully review and consider the various disclosures in this report regarding factors that could cause actual results to differ materially from anticipated results, including those factors under the caption “Risk Factors” under Item 1A below, and elsewhere in this report. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future, except as otherwise required pursuant to our on-going reporting obligations under the Securities Exchange Act of 1934, as amended.

## **Trademarks**

“Novatel Wireless,” the Novatel Wireless logo, “Merlin,” “MobiLink,” “Freedom Box,” “Expedite,” “Ovation” and “Conversa” are trademarks of Novatel Wireless, Inc. Other trademarks, trade names or service marks used in this report are the property of their owners.

**Item 1. Business**

**Overview**

We were incorporated in 1996 under the laws of the State of Delaware. We are a provider of wireless broadband access solutions for the worldwide mobile communications market. Our broad range of products includes third generation, or 3G, wireless PC card and ExpressCard modems, embedded modems, communications software and Fixed-Mobile Convergence, or FMC, solutions for wireless network operators, infrastructure providers, distributors, original equipment manufacturers, or OEMs, and vertical markets worldwide. Through the integration of our hardware and software, our products are designed to operate on a majority of global wireless networks and provide mobile subscribers with secure and convenient high speed access to corporate, public and personal information through the Internet and enterprise networks. We also offer software engineering, integration and design services to our customers to facilitate the use of our products.

Our global end-customer base is comprised of wireless operators, OEMs, distributors and various companies in other vertical markets. Our current customer base includes wireless operators and other wireless market participants such as Cingular, Hutchison 3G, O2, One, Optimus, Sprint PCS, Telefonica, Verizon Wireless, Vodafone and OEM partners such as Dell, Panasonic, Sony, and Toshiba. We have strategic technology, development and marketing relationships with several of these customers.

For the years ended December 31, 2006, 2005 and 2004, revenue recognized from sales of our products was \$218.0 million, \$161.2 million, and \$99.7 million, respectively. For the years ended December 31, 2006, 2005 and 2004, revenue recognized from development services was zero, \$500,000, and \$4.0 million, respectively.

**Our Products**

Our products are designed to operate across 3G networks, including:

- *Code Division Multiple Access*, or *CDMA*, *1xEV-DO* is designed to be employed by CDMA operators and provide wireless access speeds comparable to wireline digital subscriber line, or DSL, services. Subscribers can attain wireless access to data at maximum speeds of up to 2.4 megabits per second, or Mbps, on *CDMA 1xEV-DO* Rev 0 networks and 3.1 Mbps on *CDMA 1xEV-DO* Rev A networks.
- *High Speed Downlink Packet Access*, or *HSDPA*, is an enhancement of the *Universal Mobile Telecommunications System*, or *UMTS*, standard which enables packet data transmission in the *UMTS* downlink with data transmission at maximum speeds of up to 14.4 Mbps. *HSDPA* can be implemented as an upgrade to current *UMTS* infrastructure. With *UMTS*, subscribers can attain wireless access to data at maximum speeds of up to 384 kilobits per second, or kbps. *UMTS* is also referred to as Wideband Code Division Multiple Access, or W-CDMA.

The following table illustrates our current principal product lines and applications:

Product	Applications
<b><u>Wireless PC Card and ExpressCard Modems</u></b>	
<ul style="list-style-type: none"> <li>• Merlin Wireless PC cards and ExpressCards for CDMA 1xEV-DO, Rev 0 and Rev A</li> <li>• Merlin Wireless PC cards and ExpressCards for HSDPA</li> <li>• Merlin Wireless PC card for UMTS</li> </ul>	<ul style="list-style-type: none"> <li>• Laptop PCs and other platforms supporting PCMCIA and ExpressCard/34/54 interfaces</li> </ul>
<b><u>Expedite Embedded PCI Express Mini Card Modems</u></b>	
<ul style="list-style-type: none"> <li>• Expedite PCI Express Mini Card for HSDPA and CDMA 1xEV-DO, Rev 0 and Rev A</li> </ul>	<ul style="list-style-type: none"> <li>• Laptops and wireless devices requiring an integrated solution</li> </ul>
<b><u>Fixed-Mobile Convergence Solutions</u></b>	
<ul style="list-style-type: none"> <li>• Ovation 3G Multimedia Application Consoles for UMTS</li> </ul>	<ul style="list-style-type: none"> <li>• Broadband WWAN internet access, advanced WLAN networking, analog voice calling and intelligent routing and multimedia application support</li> </ul>
<ul style="list-style-type: none"> <li>• USB modem for CDMA 1xEV-DO Rev A</li> </ul>	<ul style="list-style-type: none"> <li>• Laptop PCs and other platforms supporting USB interfaces</li> </ul>

*Merlin Wireless PC Card and ExpressCard Modems*

Our *Merlin Wireless PC Card and ExpressCard modems* provide mobile subscribers with secure and convenient high-speed wireless access to data including corporate, public and personal information through the Internet and enterprise networks. Each of our *Merlin Wireless PC Card and ExpressCard Modems* slides inside standard laptop PCs and other products employing PCMCIA or ExpressCard/34/54 interfaces, respectively. All our modems utilize modem manager software and are compatible with a range of devices including laptop PCs, PDAs, mobile phones, as well as operating systems including Microsoft Windows 98, 2000, Millennium Edition, XP, Vista and Pocket PC. The following is a representative selection of our *Merlin Wireless PC Card and ExpressCard Modems*:

- The *Merlin PC720* is a dual band (800/1900 MHz) wireless ExpressCard modem designed to provide mobile broadband connections up to 3.1 Mbps on CDMA 1xEV-DO Rev A networks in North America and is backward compatible to legacy CDMA networks. The *Merlin PC720* incorporates an external flip antenna, maximizing data speed performance and allowing for stronger network signal reception.
- The *Merlin XV620* is a dual band (800/1900 MHz) wireless ExpressCard modem designed to provide mobile broadband connections up to 2.4 Mbps on CDMA 1xEV-DO networks in North America and is backward compatible to legacy CDMA networks.
- The *Merlin S620 and Merlin V620* are dual band (800/1900 MHz) wireless PC card modems designed to provide mobile subscribers with wireless access to data at maximum speeds of up to approximately 2.4 Mbps on CDMA 1xEV-DO networks in North America.
- The *Merlin XU870* is a tri-band HSDPA/UMTS (850/1900/2100 MHz) and quad-band EDGE/GPRS (850/900/1800/1900 MHz) wireless ExpressCard Modem designed to provide mobile subscribers with high-speed wireless access to data over 3G UMTS/HSDPA networks. The *Merlin XU870* enables mobile broadband connections up to 7.2 Mbps with software upgrade. The *Merlin XU870* operates on networks in North America, Europe and countries around the world in supported bands.
- The *Merlin U740* is a five-band (850/900/1800/1900/2100 MHz) wireless PC card modem designed to provide mobile subscribers with high-speed wireless access to data over 3G UMTS/HSDPA networks. The *Merlin U740* PC Card operates on HSDPA and UMTS 2100 MHz band networks in Asia, Europe

and the Middle East and GSM/GPRS 850, 900, 1800 and 1900 MHz band networks worldwide. The *Merlin U740* enables wireless access to data at speeds of up to 1.8 Mbps in HSDPA coverage areas, 384 kbps in UMTS coverage areas and 53.6 kbps in GPRS coverage areas.

- The *Merlin U730* is a quad-band (850/900/1800/1900 MHz) wireless PC card modem designed to provide mobile subscribers with high-speed wireless access to data over 3G UMTS/HSDPA networks. The *Merlin U730* PC Card operates on HSDPA and UMTS 850 and 1900 MHz band networks primarily in North America and GPRS/EDGE 850, 900, 1800 and 1900 MHz band networks worldwide. The *Merlin U730* enables wireless access to data at speeds of up to 1.8 Mbps in HSDPA coverage areas, 384 kbps in UMTS coverage areas and 53.6 kbps in GPRS coverage areas.
- The *Merlin U630* is a quad-band (900/1800/1900/2100 MHz) wireless PC card modem designed to provide mobile subscribers with high-speed wireless access to data over 3G UMTS networks. The *Merlin U630* PC Card operates on UMTS 2100 MHz band networks in Asia, Europe and the Middle East and GSM/GPRS 900, 1800 and 1900 MHz band networks worldwide. The *Merlin U630* enables wireless access to data at speeds of up to approximately 384 kbps in UMTS coverage areas and 53.6 kbps in GPRS coverage areas.

#### *Expedite Embedded PCI Express Mini Card Modems for OEMs*

Our *Expedite Embedded PCI Express Mini Card modems* are a form factor specification designed for easy integration into multiple laptop platforms and other wireless devices. Each *Expedite Embedded PCI Express Mini Card modem* enables wireless high-speed streaming video and audio, secure access to emails with large attachments and other corporate information stored behind firewalls providing reliable connectivity, maximum data throughput and efficient management of device power consumption. The following is a representative selection of our *Expedite Embedded PCI Express Mini Card modems*:

- The *Expedite EU740 PCI Express Mini Card* provides quad-band (850/900/1800/1900 MHz) GPRS/EDGE connectivity as well as HSDPA/UMTS access in the 2100 MHz band, and enables wireless broadband data access on HSDPA and UMTS networks at speeds up to 1.8 Mbps.
- The *Expedite EU730 PCI Express Mini Card* provides quad-band (850/900/1800/1900 MHz) GPRS/EDGE connectivity as well as HSDPA/UMTS access in the 850 and 1900 MHz bands, and enables wireless broadband data access on HSDPA and UMTS networks at speeds up to 1.8 Mbps.
- The *Expedite E720 PCI Express Mini Card* provides dual band (800/1900 MHz) wireless access and is designed to provide mobile broadband connections at speeds up to 3.1 Mbps on CDMA 1xEV-DO Rev A networks.
- The *Expedite EV620 PCI Express Mini Card* includes receive diversity on 800 and 1900 MHz band CDMA2000 1xEV-DO and CDMA2000 1X networks, and enables wireless broadband data access on CDMA 1xEV-DO networks at speeds up to 2.4 Mbps.

#### *Fixed-Mobile Convergence Solutions*

The *Ovation Family* of 3G Multimedia Application Consoles is a portfolio of stand-alone desktop consoles that unifies WWAN, WLAN and/or voice capability to provide cost-effective high speed wireless broadband access, optimal call routing and the delivery of multimedia applications. End-users are able to access *Ovation* using multiple devices, including landline telephones, cordless telephones, desktop PCs, broadband enabled laptops, emerging WLAN-enabled devices such as handsets and smartphones, and other peripheral devices. *Ovation* is powered by *Conversa*, a software suite developed by us that will enable access to advanced software applications resulting from an innovative convergence of high-speed WWAN and WLAN technologies.

The *Ovation MCD3000* provides dual band (800/1900 MHz) wireless access and is designed based on the USB standard to provide mobile broadband connections at speeds up to 3.1 Mbps on CDMA 1xEV-DO Rev A networks.

The *Ovation MCD3000* has a dual band diversity antenna system design that incorporates an external flip antenna.

### *MobiLink Mobile Communications Suite*

Residing on the mobile subscriber's laptop PC, our *MobiLink* mobile communications suite is an object-oriented software application that enables a user to gain quick and simple access to advanced connectivity features such as SMS, multimedia messaging and virtual private networking. *MobiLink* also offers video telephony and WLAN management capabilities. *MobiLink's* graphical user interface and underlying functionality are designed to be modular, easily configurable and expandable in order to enable our customers to differentiate their product offerings. *MobiLink* is engineered to work with all of our family of wireless PC modems.

### **Our Strategy**

Our objective is to be the leading provider of broadband multimedia (data and voice) solutions for the worldwide mobile communications market. The key elements of our strategy are to:

- *Broaden our Product Offering.* We intend to diversify and continue to broaden our product line in four areas: wireless PC card and ExpressCard modems, embedded modems, Fixed-Mobile Convergence solutions and software services and solutions.
- *Expand Our 3G PC Card and ExpressCard Modem Offerings Worldwide.* We intend to continue expanding our portfolio of 3G wireless PC card and ExpressCard modem products with leading wireless operators worldwide. We have introduced 14 3G products, including EV-DO and HSDPA products and plan to continue to introduce new products aimed at the next generation EV-DO, HSDPA and High Speed Uplink Packet Access, or HSUPA, technologies.
- *Lead the Embedded Market.* In 2005 and 2006, we received design wins from six leading laptop manufacturers and additional mass market device manufacturers to embed our 3G products into their product lines. These wins included Dell and Toshiba—two of the world's largest laptop manufacturer. In the future, we will continue to pursue additional opportunities with these OEM partners and with other leading laptop manufacturers as we look to consolidate the largest market share of the embedded market. For some of our OEM partners, we build to order; for others, our technology is embedded in specific wireless SKUs; and for others, our technology is embedded into complete laptop lines. Most of our customers are addressing world-wide markets and are shipping both our EV-DO and HSDPA products.
- *Capitalize on Our Direct Relationships with Wireless Operators.* We intend to continue to capitalize on our direct relationships with wireless operators in order to increase our worldwide market position. In the United States and internationally, we are working closely with wireless operators of 3G EV-DO, UMTS and HSDPA wireless networks.
- *Leverage Strategic Relationships with Wireless Industry Leaders.* We believe that strategic relationships with wireless and mobile computing industry leaders are critical to our ability to leverage sales opportunities and ensure that our technology investments address customer needs. Through strategic relationships, we believe that we can increase market penetration and differentiate our products by accessing the resources of others, including access to distribution resources, exclusive sales and marketing and addressing new market opportunities through innovation with our selected partners. We intend to continue the development and leverage of strategic alignments in the industry.
- *Continue to Target Key Vertical Market Opportunities and Penetrate New Markets.* We believe that on-going developments in wireless technologies will create additional vertical market opportunities and more applications for our products. Currently, we market our broadband wireless access solutions to key vertical industry segments by offering innovative products that increase productivity, reduce costs and create operational efficiencies.

- *Increase the Value of Our Products.* We will continue to add new features and functionality to our products and develop new services and software applications to enhance the overall value and ease of use that our products provide to our customers and end users.

## **Customers**

Our global end-customer base is comprised of wireless operators, OEMs, distributors and various companies in other vertical markets. Our current customer base includes wireless operators and other wireless market participants such as Cingular, Hutchison 3G, O2, One, Optimus, Sprint PCS, Telefonica, Verizon Wireless, Vodafone and OEM partners such as Dell, Panasonic, Sony and Toshiba.

Our strong customer relationships provide us with the opportunity to expand our market reach and sales:

- *Wireless Operators and Distributors.* By working closely with our wireless operator and distributor customers, we are able to drive demand for our products by combining our expertise in wireless technologies with our customers' sales and marketing reach over a global subscriber base. Our customers also provide us with important services, including field trial participation, technical support, wireless data marketing and access to additional indirect distribution channels.
- *OEMs.* Our OEM customers integrate our products into devices that they manufacture and sell to end-users through their own direct sales forces and indirect distribution channels. Our products are capable of being integrated into a broad range of devices, including but not limited to laptop PCs, PDAs, M2M devices, and vehicle location devices. We seek to build strong relationships with our OEM customers by working closely with them and providing radio frequency, or RF, design consulting, performance optimization, software integration and customization and application engineering support during the integration of our products.

## **Strategic Relationships**

We continue to develop and maintain strategic relationships with wireless and computing industry leaders like Alcatel, Siemens, Dell, QUALCOMM, Sprint PCS, Verizon Wireless and Vodafone and major software vendors. Through strategic relationships, we have been able to increase market penetration by leveraging the resources of our channel partners, including their access to distribution resources, increased sales opportunities and market opportunities.

Our strategic relationships include technology and marketing relationships with wireless operators, OEM customers that integrate our products into other devices, distributors and leading hardware and software technology providers.

## **Sales and Marketing**

We sell our wireless broadband solutions primarily to wireless operators either directly or through strategic relationships, as well as to OEMs and distributors located worldwide. Most of our sales to wireless operators and OEMs are sold directly through our sales force. To a lesser degree, we also use an indirect sales distribution model through the use of select distributors. A significant portion of our revenues comes from a small number of customers. Our revenues from sales to Sprint PCS and Verizon Wireless represented approximately 38.2% and 19.7%, respectively, of our total revenues for the year ended December 31, 2006.

In order to maintain strong sales relationships, we provide co-marketing, trade show support, product training and demo units for merchandising. We are also engaged in a wide variety of activities, such as awareness and lead generation programs as well as product marketing. Other marketing initiatives include public relations, seminars, and co-marketing and co-branding with partners.

We are continuing to drive widespread adoption of our products through increased global marketing activities, expansion of our sales team and distribution networks and continued leverage of our strategic relationships with wireless industry leaders.

We have operations in the United States, Canada and the United Kingdom. The amount of our assets in the United States, Canada and the United Kingdom as of December 31, 2006 were \$172.8 million, \$18.0 million, and \$835,000, respectively. As of December 31, 2005 the amount of our assets in the United States, Canada and the United Kingdom were \$166.5 million, \$9.6 million and zero, respectively, and as of December 31, 2004 were \$114.0 million, \$2.3 million and zero, respectively.

For the years ended December 31, 2006, 2005 and 2004, approximately 37%, 58% and 76%, respectively, of our revenue was derived from international customers. See Note 10 to our Consolidated Financial Statements for further explanation of our revenue based on geography. Our continuing reliance on sales in international markets exposes us to risks attendant to foreign sales. See "Item 1A. Risk Factors—We are subject to the risks of doing business abroad, which could negatively affect our international sales activities and our ability to obtain products from our foreign manufacturers".

### **Product Research and Development**

Our product development efforts are focused on developing innovative wireless broadband access solutions to address opportunities presented by next generation wireless networks and improving the functionality, design and performance of our products. Our research and development expenses for the years ended December 31, 2006, 2005 and 2004 were \$31.3 million, \$20.5 million and \$10.6 million, respectively. In addition, costs recovered from customer funded development contracts for the years ended December 31, 2006, 2005 and 2004 were zero, \$200,000 and \$2.9 million, respectively, and were included in cost of revenue.

We intend to continue to identify and respond to our customers' needs by introducing new product designs with an emphasis on supporting cutting edge WAN technology, ease-of-use, performance, size, weight, cost and power consumption.

We manage our products through a structured life cycle process, from identifying initial customer requirements through development and commercial introduction to eventual phase-out. During product development, emphasis is placed on time-to-market, meeting industry standards and customer product specifications, ease of integration, cost reduction, manufacturability, quality and reliability.

Our product development efforts leverage our core expertise in the following key technology areas:

- *Advanced Radio Frequency and Hardware Design.* Advanced Radio Frequency, or RF, design is the key technology that determines the performance of wireless devices. We have specialized in 800/900/1800/1900 and 2100 MHz designs for digital cellular, packet data and CDMA technology. Our expertise in RF and baseband technology contributes to the performance, cost advantages and small size of our products.
- *Miniaturization and System Integration.* Small systems integration is the integration of application specific integrated circuits, or ASICs, RF and baseband integrated circuits and packaging technologies. The complete wireless modem is packaged into a module less than half the size of a credit card through the use of advanced integrated circuit designs, embedded software modems and multi-layer RF stripline technologies. We will continue to augment our miniaturization technology, working to further reduce the size and cost of current and future products.
- *Firmware and Software development.* We have specialized in integrating 3G (HSDPA and 1xEV-DO) protocol stacks and customizing the firmware to meet carrier and regulatory requirements. We supply end-to-end WAN modem solutions to our customers including the modem hardware, the customized firmware that runs on the 3G processor and the modem manager application that controls the modem operation.

## **Manufacturing and Operations**

In September 2002, we entered into an agreement with LG Innotek Co., Ltd, or LG Innotek, a subsidiary of LG Group, located in South Korea, for the outsourced manufacturing of our products. In August 2006, we entered into an agreement with Inventec Appliances Corp., or IAC, pursuant to which IAC manufactures certain products for us in China. Under our manufacturing agreements, LG Innotek and IAC provide us with services including component procurement, product manufacturing, final assembly, testing, quality control, fulfillment and delivery. In addition, in June 2005 we entered into an agreement with Mobiltron (Europe) Limited, or Mobiltron, for certain distribution and fulfillment services related to our business in Europe, Middle East, and Africa, or EMEA.

We outsource our manufacturing in an effort to:

- focus on our core competencies;
- minimize our capital expenditures and lease obligations;
- realize manufacturing economies of scale;
- achieve production scalability by adjusting manufacturing volumes to meet changes in demand; and
- access best-in-class manufacturing resources.

We believe that additional assembly line efficiencies are realized due to our product architecture and our commitment to process design. Direct materials for our products consist of tooled parts such as printed circuit boards, molded plastic components, metal components and ASICs, as well as industry-standard components such as transistors, integrated circuits, piezo-electric filters, duplexers, inductors, resistors and capacitors. Many of the components used in our products are similar to those used in cellular telephone handsets, helping to reduce our manufacturing costs through the use of standard components.

Our operations organization manages our relationships with LG Innotek, IAC and Mobiltron as well as key second tier suppliers. The organization focuses on improvements in design-for-manufacturing, test procedures, quality, cost optimization, production scheduling, order management and new product introduction.

## **Intellectual Property**

Our wireless broadband access solutions and operations rely on and benefit from our portfolio of intellectual property. We currently own 31 United States patents, two of which are also registered in Canada. In addition, we currently have 23 United States patent applications pending. From time to time we also seek to have our patents registered in selected foreign jurisdictions. The patents that we currently own expire at various times between 2007 and 2023.

We hold a number of trademarks including Merlin, Expedite, MobiLink, Ovation, and Conversa, each with its accompanying designs, as well as the Novatel Wireless name and logo.

We have licensed software and other intellectual property for use in our products from third-parties, such as QUALCOMM. In the case of QUALCOMM, these licenses allow us to manufacture CDMA, UMTS, HSDPA and EV-DO-based wireless modems and to sell or distribute them worldwide. In connection with such sales, we pay royalties to QUALCOMM. The license from QUALCOMM does not have a specified term and may be terminated by us or by QUALCOMM for cause or upon the occurrence of other specified events. In addition, we may terminate the licenses for any reason upon 60 days prior written notice. We have also granted to QUALCOMM a nontransferable, worldwide, nonexclusive, fully-paid and royalty-free license to use, in connection with wireless communications applications, certain intellectual property of ours that is used in our products which incorporate the CDMA technology licensed to us by QUALCOMM. This license allows QUALCOMM to make, use, sell or dispose of such products and the related components.

## **Backlog**

We do not believe that backlog is a meaningful indicator of our future business prospects due to the many variables, some outside our control, which could cause the actual volume of our product shipments to differ from those that comprise the backlog, and our dependency on evolving wireless network standards. Therefore, we do not believe that backlog information is relevant to an understanding of our overall business.

## **Competition**

The market for wireless broadband access solutions is rapidly evolving and highly competitive. It is likely to continue to be significantly affected by the evolution of new wireless technology standards, new product introductions and the market activities of industry participants. We believe the principal competitive factors impacting the market for our products are form factor, time-to-market, features and functionality, performance, quality, brand and price. To maintain and improve our competitive position, we must continue to develop new products, expand our customer base, grow our distribution network and leverage our strategic relationships.

Our wireless communications products currently compete with a variety of devices, including other wireless modems, wireless handsets, wireless handheld computing devices and other wireless devices. Our current and potential competitors include:

- wireless data modem providers, such as Huawei, Option International, Sierra Wireless, Kyocera, and Sony-Ericsson; and
- wireless handset and infrastructure manufacturers, such as Motorola, Nokia, Siemens and Sony-Ericsson.

We believe that we have advantages over each of our primary competitors due to the technical and engineering design of our products, the broad range of solutions that we offer, the ease-of-use of our products, our ability to adapt our products to specific customer needs and our competitive pricing. As the market for wireless broadband access solutions expands, other entrants may seek to compete with us.

## **Employees**

As of December 31, 2006, we had 235 employees, including 36 in operations, 44 in sales and marketing, 121 in product development and research, and 34 in general and administrative functions. We also use the services of consultants and temporary workers from time to time. Our employees are not represented by any collective bargaining unit and we consider our relationship with our employees to be good.

## **Website Access to SEC Filings**

We maintain an Internet website at [www.novatelwireless.com](http://www.novatelwireless.com). The content of our website is not part of this report. We make available, free of charge, through our Internet website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission, or SEC.

**Item 1A. Risk Factors**

*Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described below in addition to the other cautionary statements and risks described elsewhere, and the other information contained in this Report and in our filings with the SEC. The risk and uncertainties described below are those that we currently deem to be material, and do not represent all of the risks that we face. Additional risks and uncertainties not presently known to us or that we currently consider immaterial may in the future become material and impair our business operations. If any of the following risks actually occur, our business could be materially harmed, and our financial condition and results of operations could be materially and adversely affected. As a result, the trading price of our securities could decline, and you might lose all or part of your investment. You should also refer to the other information contained in this Form 10-K, including our financial statements and the related notes.*

***The market for wireless broadband data access products is highly competitive, and we may be unable to compete effectively.***

The market for wireless broadband data access products is highly competitive, and we expect competition to continue to increase and intensify. Many of our competitors or potential competitors have significantly greater financial, technical, operational and marketing resources than we do. These competitors, for example, may be able to respond more rapidly or more effectively than we can to new or emerging technologies, changes in customer requirements, supplier related developments, or a shift in the business landscape. They also may devote greater resources than we do to the development, promotion, sale, and post-sale support of their respective products.

Many of our current or potential competitors have more extensive customer bases and broader customer, supplier and other industry relationships that they can leverage to establish competitive dealings with many of our current and potential customers. Some of these companies also have more established and larger customer support organizations than we do. In addition, these companies may adopt more aggressive pricing policies or offer more attractive terms to customers than they currently do or than we are able to, may bundle their competitive products with broader product offerings and may introduce new products and enhancements. Current and potential competitors might merge or otherwise establish cooperative relationships among themselves or with third parties to enhance their products or market position. As a result, it is possible that new competitors or new relationships among existing competitors may emerge and rapidly acquire significant market share to the detriment of our business.

Our wireless communications products currently compete with a variety of devices, including other wireless modems, wireless handsets, wireless handheld computing devices and other wireless devices. Our current and potential competitors include:

- wireless data modem providers, such as Huawei, Option, Sierra Wireless, Kyocera, and Sony-Ericsson; and
- wireless handset providers, such as Motorola, Nokia, Siemens and Sony-Ericsson.

We expect our competitors to continue to improve the features and performance of their current products and to introduce new products, services and technologies. Successful new product introductions or enhancements by our competitors could reduce our sales and the market acceptance of our products, cause intense price competition and make our products obsolete. To be competitive, we must continue to invest significant resources in, among other things, research and development, sales and marketing, and customer support. We cannot be sure that we will have sufficient resources to make these investments or that we will be able to make the technological advances necessary for our products to remain competitive. Increased competition could result in price reductions, fewer or smaller customer orders, reduced margins and loss of our market share. Our failure to compete successfully could seriously harm our business, financial condition and results of operations.

***Our failure to predict and comply with evolving wireless industry standards, including 3G standards, could hurt our ability to introduce and sell new products.***

In our industry, it is critical to our success that we accurately anticipate evolving wireless technology standards and that our products comply with such standards in relevant respects. We are currently focused on engineering and manufacturing products that comply with several different 3G wireless standards. Any failure of our products to comply with any one of these or future applicable standards could prevent or delay their introduction and require costly and time-consuming engineering changes. Additionally, if an insufficient number of wireless operators or subscribers adopt the standards to which we engineer our products, then sales of our new products designed to those standards could be materially harmed.

***If we fail to develop and introduce new products successfully, we may lose key customers or product orders and our business could be harmed.***

The development of new wireless data products requires technological innovation and can be difficult, lengthy and costly. In addition, wireless operators require that wireless data systems deployed on their networks comply with their own technical and product performance standards, which may differ from the standards our products are required to meet for other operators. This increases the complexity of the product development process. In addition, as we introduce new versions of our existing products or new products altogether, our current customers may not require or desire the technological innovations of these products and may not purchase them or might purchase them in smaller quantities than we had expected.

Further, as part of our strategy, we enter into contracts with some customers pursuant to which we develop products for later sale to the customer. Our ability to generate future revenue and operating income under any such contracts depends upon, among other factors, our ability to timely develop products that are suitable for manufacturing and in a cost effective manner and that meet defined product design, technical and performance specifications. Our ability to maximize the benefits of these contracts depends in part on the following:

- We have priced the products to be sold under these contracts based on our estimated development, production and post-production warranty costs. If these or other related development and production costs are actually higher than our estimated costs, our gross margins and operating margins on the corresponding contracts will be less than anticipated.
- If we are unable to commit the necessary engineering, program management and other resources or are otherwise unable to successfully develop products as required by the terms of these contracts, our customers may cancel the related contracts, we may not be entitled to recover any costs that we incurred for research and development, sales and marketing, production and otherwise, and we may be subject to additional costs such as contractual penalties.
- If we fail to deliver in a timely manner a product that is suitable for manufacture or if a customer determines that a prototype product we delivered does not meet the agreed-upon specifications, we may be unable to commercially launch the product, we may have to reduce the price we charge for such product if it launches, or we may be required to pay damages to the customer.

If we are unable to successfully manage these risks or meet required delivery specifications or deadlines in connection with one or more of our key contracts, we may lose key customers or orders and our business could be harmed.

***If we fail to develop and maintain strategic relationships, we may not be able to penetrate new markets.***

A key element of our business strategy is to penetrate new markets by developing new products through strategic relationships with industry leaders in wireless communications. We are currently investing, and plan to continue to invest, significant resources to develop these relationships. We believe that our success in penetrating new markets for our products will depend, in part, on our ability to develop and maintain these relationships and

to cultivate additional or alternative relationships. There can be no assurance, however, that we will be able to develop additional strategic relationships, that existing relationships will survive and successfully achieve their purposes or that the companies with whom we have strategic relationships will not form competing arrangements with others or determine to compete unilaterally with us.

***Since we have historically depended, and continue to depend, upon only a small number of our customers for a substantial portion of our revenues, our business could be negatively affected by an adverse change in our dealings with only a few customers.***

A significant portion of our revenue comes from a small number of customers. Our top ten customers for the years ended December 31, 2006 and 2005 accounted for approximately 83.3% and 80.3% of our revenue, respectively. Similarly, our revenue could be adversely affected if we are unable to retain the level of business of any of our significant customers or if we are unable to diversify our customer base. We expect that a small number of customers will combine to account for a substantial amount of our revenue for the foreseeable future.

In addition, our current customers typically purchase our products pursuant to overarching contracts that do not require them to purchase any specific minimum quantity of units other than as indicated on individual purchase orders. Such customers have no contractual obligation to continue to purchase our products and if they do not continue to make purchases consistent with their historical purchase levels, our revenue and our share price may decline.

***The sale of our products depends on the demand for broadband wireless access to enterprise networks and the Internet.***

The markets for broadband wireless access solutions are relatively new and rapidly evolving, both technologically and competitively, and the successful sale of related products and services depends in part on the strength of the demand for wireless access to enterprise networks and the Internet. In the past, market demand for both wireless products and wireless access services for the transmission of data developed at a slower rate than we had anticipated and as a result our product sales did not generate sufficient revenue to cover our operating costs. The failure of these markets to continue to grow at the rate that we currently anticipate may adversely impact our rate of growth and the growth in the demand for our products, and as a result, our business, financial condition and results of operations may be harmed.

***The marketability of our products may suffer if wireless telecommunications operators do not deliver acceptable wireless services.***

The success of our business depends, in part, on the capacity, affordability, reliability and prevalence of wireless data networks provided by wireless telecommunications operators and on which our products operate. Currently, various wireless telecommunications operators, either individually or jointly with us, sell our products in connection with the sale of their wireless data services to their customers. Growth in demand for wireless data access may be limited if, for example, wireless telecommunications operators cease or materially curtail operations, fail to offer services which customers consider valuable, fail to maintain sufficient capacity to meet demand for wireless data access, delay the expansion of their wireless networks and services, fail to offer and maintain reliable wireless network services or fail to market their services effectively. In addition, our future growth depends on the successful deployment of next generation wireless data networks provided by third parties, including those networks for which we are currently developing products. If these next generation networks are not deployed or widely accepted, or if deployment is delayed, there will be no market for the products we are developing to operate on these networks. If any of these events occur, or if for any other reason the demand for wireless data access fails to grow, sales of our products will decline and our business could be harmed.

***If we do not properly manage the growth of our business, we may experience significant strains on our management and operations and disruptions in our business.***

Various risks arise when companies and industries grow quickly. If our business or industry grows too quickly, our ability to meet customer demand in a timely and efficient manner could be challenged. We may also experience development or production delays as we seek to meet increased demand for our products. Our failure to properly manage the growth that we or our industry might experience could negatively impact our ability to execute on our operating plan and, accordingly, could have an adverse impact on our business, our cash flow and results of operations, and our reputation with our current or potential customers.

***We currently rely on third parties to manufacture our products, which exposes us to a number of risks and uncertainties outside our control.***

We currently outsource our manufacturing to LG Innotek and IAC. If one of these third-party manufacturers were to experience delays, disruptions, capacity constraints or quality control problems in its manufacturing operations, product shipments to our customers could be delayed or our customers could consequently elect to cancel the underlying product purchase order, which would negatively impact our revenues and our competitive position and reputation. Further, if we are unable to manage successfully our relationship with a manufacturer, the quality and availability of our products may be harmed. None of our third-party manufacturers is obligated to supply us with a specific quantity of products, except as may be provided in a particular purchase order which we may submit to them from time to time. Therefore, such a third-party manufacturer could at any time and at its sole election decline to accept new purchase orders from us or otherwise reduce its respective business with us. If such a manufacturer stopped manufacturing our products for any reason or reduced manufacturing capacity, we may be unable to replace the lost manufacturing capacity on a timely basis, which would adversely impact our operations. In addition, if a third-party manufacturer were to negatively change the payment and other terms under which it agrees to manufacture for us and we are unable to locate a suitable alternative manufacturer, our manufacturing costs could significantly increase.

Because we outsource the manufacture of all of our products, the cost, quality and availability of third-party manufacturing operations are essential to the successful production and sale of our products. Our reliance on third-party manufacturers exposes us to a number of risks which are outside our control, including:

- unexpected increases in manufacturing costs;
- interruptions in shipments if a third-party manufacturer is unable to complete production in a timely manner;
- inability to control quality of finished products;
- inability to control delivery schedules;
- inability to control production levels and to meet minimum volume commitments to our customers;
- inability to control manufacturing yield;
- inability to maintain adequate manufacturing capacity; and
- inability to secure adequate volumes of acceptable components, at suitable prices or in a timely manner.

Although we promote ethical business practices and our operations personnel periodically visit and monitor the operations of our manufacturers, we do not control the manufacturers or their labor practices. If our current manufacturers, or any other third-party manufacturer which we use in the future, violate United States or foreign laws or regulations, we may be subjected to extra duties, significant monetary penalties, adverse publicity, the seizure and forfeiture of products that we are attempting to import or the loss of our import privileges. The effects of these factors could render the conduct of our business in a particular country undesirable or impractical and have a negative impact on our operating results.

***We might forecast customer demand incorrectly and order the manufacture of excess or insufficient quantities of particular products.***

We have historically placed purchase orders with our manufacturers at least three months prior to the scheduled delivery of the finished goods to our customer. In some instances, due to the length of component lead times, we might need to place manufacturing orders on the basis of our receipt of a good-faith but non-binding customer forecast of the quantity and timing of the customer's expected purchases from us. Accordingly, if we inaccurately anticipate customer demand for our products, we might be unable to obtain adequate quantities of components to meet our customers' delivery requirements or, alternatively, we might accumulate excess inventory. Our operating results and financial condition have been in the past and may in the future be materially adversely affected by our ability to manage our inventory levels and respond to short-term or unexpected shifts in customer demand as to quantities or the customer's product delivery schedule.

***We depend on sole source suppliers for some components used in our products, and therefore the availability and sale of those finished products would be harmed if any of these suppliers is not able to meet our demand and in accordance with our production schedule and alternative suitable components are not available.***

Our products contain a variety of components, many of which are procured from single suppliers. These components include both tooled parts and industry-standard parts, many of which are also used in cellular telephone handsets. From time to time, certain components used in our products have been in short supply worldwide or their anticipated commercial introduction has been delayed. If there is a shortage of any such components, and we cannot obtain a suitable substitute or make sufficient and timely design or other product modifications to permit the use of such a substitute, we may not be able to timely deliver sufficient quantities of our products to satisfy demand. Moreover, if we locate a substitute and its price is prohibitive, our ability to maintain cost-effective production of our products would be seriously harmed.

***Others might claim that our products infringe on their respective intellectual property rights, which may result in substantial costs, diversion of resources and management attention, harm to our reputation or interference with our current or prospective customer relations.***

It is possible that other parties may claim that we have violated their respective intellectual property rights. An infringement claim, regardless of the merits or success of the claim, could result in substantial costs, diversion of resources and management attention and harm to our reputation. Infringement claims can be difficult and costly to verify and assess. A successful infringement claim against us could cause us to be liable for damages and litigation costs. In addition, a successful infringement claim could have other negative consequences, including prohibiting us from further use of the intellectual property or causing us to have to license the intellectual property, thereby incurring licensing fees, some of which could be retroactive. Upon the occurrence of a successful infringement claim, we may also have to develop a non-infringing alternative, which if available could be costly, and delay or prevent sales of our products.

***We may not be able to license necessary third-party technology or it may be expensive to do so.***

We license technology from third parties for the development of our products. We have licensed from third parties, such as QUALCOMM, software and other intellectual property for use in our products and from time to time we may elect or be required to license additional intellectual property. The license from QUALCOMM, for example, does not have a specified term and may be terminated by us or by QUALCOMM for cause or upon the occurrence of other specified events. There can be no assurance that we will be able to maintain our third-party licenses or that additional third-party licenses will be available to us on commercially reasonable terms, if at all. The inability to maintain or obtain third-party licenses required for our products or to develop new products and product enhancements could require us to seek to obtain substitute technology of lower quality or performance standards, if such exists, or at greater cost which could seriously harm our competitive position, revenue and growth prospects.

***We are subject to the risks of doing business abroad, which could negatively affect our international sales activities and our ability to obtain products from our foreign manufacturers.***

In addition to our manufacturing activities in Asia, a significant portion of our sales activity takes place in Europe. In addition, a significant portion of our research and development staff is located in Canada. Our international sales accounted for approximately 37% of our revenue for the year ended December 31, 2006 and 58.4% for the year ended December 31, 2005. Although our experience in marketing, selling, distributing and manufacturing our products and services internationally is limited, we expect to further expand our international sales and marketing activities in the future. Consequently, we are subject to certain risks associated with doing business abroad, including:

- difficulty in managing widespread sales, research and development operations and post sales logistics and support;
- changes in a specific country's or region's political or economic conditions, particularly in emerging markets, and changes in diplomatic and trade relationships;
- less effective protection of intellectual property and general exposure to different legal standards;
- trade protection measures and import or export licensing requirements;
- potentially negative consequences from changes in tax laws;
- increased expenses associated with customizing products for different countries;
- unexpected changes in regulatory requirements resulting in unanticipated costs and delays;
- longer collection cycles and difficulties in collecting accounts receivable;
- longer sales cycles;
- international terrorism;
- loss or damage to products in transit; and
- international dock strikes or other transportation delays.

Any disruption in our ability to obtain products from our foreign manufacturers or our ability to conduct international operations and sales could have a material adverse effect on our business, financial condition and results of operations.

***To the extent we enter into contracts that are denominated in foreign currencies and do not adequately hedge that exposure, fluctuations in exchange rates between the United States dollar and foreign currencies may affect our operating results.***

A significant amount of our revenues are generated from sales agreements denominated in foreign currencies, particularly the Euro, and we expect to enter into additional such agreements as we expand our international customer base. As a result, we transact some of our business in foreign currencies, which exposes us to changes in foreign currency exchange rates and we currently expect the absolute value of this exposure may increase in the future. We attempt to manage this risk, in part, by minimizing the effects of volatility on cash flows by identifying forecasted transactions exposed to these risks and using foreign exchange forward contracts. There can be no assurance that we will not incur foreign currency losses or that foreign exchange forward contracts we may enter into to reduce the risk of such losses will be successful.

***Our products may contain errors or defects, which could prevent or decrease their market acceptance and lead to unanticipated costs or other adverse business consequences.***

Our products are technologically complex and must meet stringent user requirements. We must develop our software and hardware products quickly to keep pace with the rapidly changing and technologically advanced

wireless communications market. Products as sophisticated as ours may contain undetected errors or defects, especially when first introduced or when new models or versions are released. Our products may not be free from errors or defects after commercial shipments have begun, which could result in the rejection of our products, the loss of a customer or the failure to obtain one, damage to our reputation, lost revenue, diverted development resources, increased customer service and support costs, unanticipated warranty claims, and the payment of monetary damages to our customers.

***Our quarterly operating results may vary significantly from quarter to quarter and may cause our stock price to fluctuate.***

Our future quarterly operating results may fluctuate significantly and may fall short of or exceed the expectations of securities analysts, investors or management. If this occurs, the market price of our stock could fluctuate, in some cases materially. The following are some of the factors that may cause fluctuations in our operating results:

- *Decreases in revenue or increases in operating expenses.* We budget our operating expenses based on anticipated sales, and a significant portion of our sales and marketing, research and development and general and administrative costs are fixed, at least in the short term. If revenue decreases or does not grow as planned and we are unable to reduce our operating costs quickly and sufficiently, our operating results could be materially adversely affected.
- *Product mix.* The product mix of our sales affects profit margins in any given quarter. As our business evolves and the revenue from the product mix of our sales varies from quarter to quarter, our operating results will likely fluctuate.
- *New product introductions.* As we introduce new products, the timing of these introductions within any given quarter will affect our quarterly operating results. We may have difficulty predicting the timing of new product introductions and the market acceptance of these new products. If products and services are introduced earlier or later than anticipated, or if market acceptance is unexpectedly high or low, our quarterly operating results may fluctuate unexpectedly.
- *Lengthy sales cycle.* The length of time between the date of initial contact with a potential customer and the execution of and product delivery under a contract may take several months, or longer, and is subject to delays or permanent interruptions over which we have little or no control. The sale of our products is subject to delays from, among other things, our customers' budgeting, product testing and vendor approval mechanics, and competitive evaluation processes that typically accompany significant information technology purchasing decisions. As a result, our ability to anticipate the timing and volume of sales to specific customers is limited, and the delay or failure to complete one or more large transactions could cause our operating results to vary significantly from quarter to quarter.
- *Foreign currency.* We are exposed to market risk from changes in foreign currency exchange rates. As a significant amount of our revenues are generated in the Euro currency, we use foreign exchange forward contracts to minimize exposure to the risk of loss on changes in foreign currency exchange rates upon the eventual net cash inflows from foreign currency denominated sales with our customers. Since there is a high correlation between the hedging instruments and the underlying exposures, the gains and losses on these underlying exposures are generally offset by reciprocal changes in the value of the hedging instruments. We use derivative financial instruments as risk management tools and not for trading or speculative purposes. Fluctuations in the Euro currency may have a material impact on our future operating results and gross margins.

Due to these and other factors, our results of operations may fluctuate substantially in the future and quarter-to-quarter comparisons may not be reliable indicators of future operating or share price performance.

***We incurred significant operating losses and negative cash flows between the date of our inception and the beginning of 2004 and if our revenue and gross margins decline or we are unable to increase our revenue and gross margins relative to our operating expenses, we may incur significant net losses and negative cash flow from operations.***

We incurred significant operating losses and net losses in each annual period between the date of our inception until the beginning of 2004. In 2004, we reached profitability for the first time since our inception and recorded net income available to common stockholders of \$13.7 million for the year ended December 31, 2004. We incurred net losses applicable to common stockholders of \$16.7 million for the fiscal year ending 2003 and \$53.5 million for the fiscal year ending 2002. We had positive cash flows from operations of \$5.6 million for the year ended December 31, 2004, while we had negative cash flows from operations of \$400,000 for the fiscal year ending December 31, 2003 and \$28.7 million for the fiscal year ending December 31, 2002. As of December 31, 2006, we had an accumulated deficit of \$221.9 million. If we are unable to generate revenue and gross margins to sufficiently offset our increasing expenses, we may not maintain profitability and may incur operating losses, net losses and negative cash flow from operations.

***We may not be able to maintain and expand our business if we are not able to hire, retain and manage additional qualified personnel.***

Our success in the future depends in part on the continued contribution of our executive, technical, engineering, sales, marketing, operations and administrative personnel. Recruiting and retaining skilled personnel in the wireless communications industry, including software and hardware engineers, is highly competitive.

Although we may enter into employment agreements with members of our senior management in the future, currently none of our senior management or other key personnel is bound by an employment agreement. If we are not able to attract or retain qualified personnel in the future, or if we experience delays in hiring required personnel, particularly qualified engineers, we will not be able to maintain and expand our business.

***Any acquisitions we make could disrupt our business and harm our financial condition and results of operations.***

As part of our business strategy, we review and intend to continue to review, on an ongoing basis, acquisition opportunities that we believe would be advantageous or complementary to the development of our business. While we have no current agreements or plans with respect to any acquisitions, we may acquire businesses, assets, or technologies in the future. If we make any acquisitions, we could take any or all of the following actions, any one of which could adversely affect our business, financial condition, results of operations or share price:

- issue equity or equity-based securities that would dilute existing stockholders' percentage ownership;
- use a substantial portion of our available cash;
- incur substantial debt, which may not be available to us on favorable terms and may adversely affect our liquidity;
- assume contingent liabilities; and
- take substantial charges in connection with acquired assets.

Acquisitions also entail numerous other risks, including: difficulties in assimilating acquired operations, products, technologies and personnel; unanticipated costs; diversion of management's attention from other business concerns; adverse effects on existing business relationships with suppliers and customers; risks of entering markets in which we have limited or no prior experience; and potential loss of key employees from either our preexisting business or the acquired organization. We may not be able to successfully integrate any businesses, products, technologies or personnel that we might acquire in the future, and our failure to do so could harm our business and operating results.

***Any changes to existing accounting pronouncements or taxation rules or practices may cause adverse fluctuations in our reported results of operations or affect how we conduct our business.***

A change in accounting pronouncements or taxation rules or practices can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. Other new accounting pronouncements or taxation rules and varying interpretations of accounting pronouncements or taxation practices have occurred and may occur in the future. The change to existing rules, future changes, if any, or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

***We may not be able to develop products that comply with applicable government regulations.***

Our products must comply with government regulations. For example, in the United States, the Federal Communications Commission, or FCC, regulates many aspects of communications devices, including radiation of electromagnetic energy, biological safety and rules for devices to be connected to telephone networks. In addition to the federal government, some states have adopted regulations applicable to our products. Radio frequency devices, which include our modems, must be approved under the above regulations by obtaining equipment authorization from the FCC prior to being offered for sale. Regulatory requirements in Canada, Europe, Asia and other jurisdictions must also be met. Additionally, we cannot anticipate the effect that changes in domestic or foreign government regulations may have on our ability to develop and sell products in the future. Failure to comply with existing or evolving government regulations or to obtain timely regulatory approvals or certificates for our products could materially adversely affect our business, financial condition and results of operations or cash flows.

**Item 1B. *Unresolved Staff Comments***

None

**Item 2. *Properties***

Our principal executive offices are located in San Diego, California where we lease approximately 45,000 square feet under an arrangement that expires in December 2010. In Calgary, we lease approximately 42,000 square feet for our research and development organization under a lease that expires in September 2007, of which we have subleased 24,000 square feet for the duration of this lease. In Basingstoke, United Kingdom, we lease approximately 4,000 square feet for our European staff under a lease agreement that expires in December 2011. We also lease space in various geographic locations abroad primarily for sales and support personnel or for temporary facilities. We believe that our existing facilities are adequate to meet our current needs and that we can renew our existing leases or obtain alternative space on terms that would not have a material impact on our financial results.

**Item 3. *Legal Proceedings***

We are from time to time party to various legal proceedings arising in the ordinary course of business. Based on evaluation of these matters and discussions with our counsel, we believe that liabilities arising from or sums paid in settlement of these matters will not have a material adverse effect on the consolidated results of our operations or financial position.

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

No matters were submitted to a vote of our stockholders during the fourth quarter of 2006.

PART II

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

**Common Stock Data**

Our common stock is traded on The Nasdaq Global Market under the symbol "NVTL." The following table sets forth, for the periods indicated, the high and low closing prices of our common stock as reported on Nasdaq, without retail mark-up, mark-down or commissions and may not necessarily represent actual transactions.

	<u>High</u>	<u>Low</u>
<b>2006</b>		
First quarter	\$ 12.96	\$ 8.16
Second quarter	\$ 11.46	\$ 8.82
Third quarter	\$ 11.96	\$ 9.63
Fourth quarter	\$ 9.84	\$ 8.14
<b>2005</b>		
First quarter	\$ 17.46	\$ 9.97
Second quarter	\$ 14.21	\$ 8.70
Third quarter	\$ 15.54	\$ 10.42
Fourth quarter	\$ 14.48	\$ 11.97

On March 2, 2007 the closing price per share of our common stock was \$13.33, as reported by Nasdaq.

**Number of Shareholders of Record**

We have only one class of common stock. As of March 2, 2007 there were approximately 110 holders of record of our common stock. Because many of the shares of our common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

**Dividends**

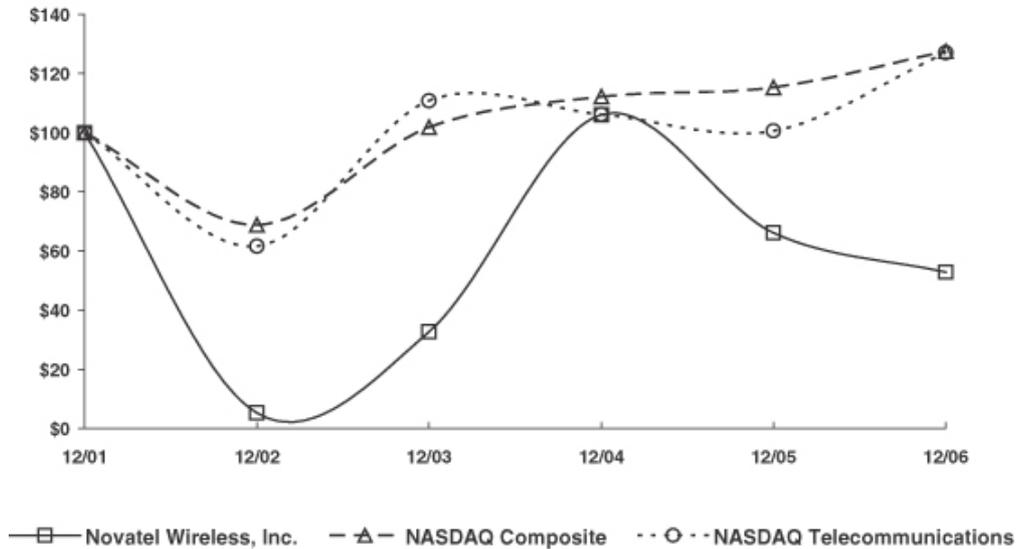
No cash dividends were declared or paid in 2005 or 2006 on any shares of our capital stock. We currently intend to retain all available funds for use in the operation and development of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. Any future determination relating to our dividend policy will be made at the discretion of our board of directors and will depend on a number of factors, including future earnings, capital requirements, financial condition and future prospects and other factors the board of directors may deem relevant.

## Performance Graph

The following graph compares the cumulative total stockholder return on the Company's common stock between December 31, 2001 and December 31, 2006 with the cumulative total return of (i) the Nasdaq Stock Market (U.S.) Index ("Nasdaq Index") and (ii) the Nasdaq Telecommunications Index (the "Nasdaq Telecom Index"), over the same period. This graph assumes the investment of \$100.00 on December 31, 2001 in the common stock of the Company, the Nasdaq Index and the Nasdaq Telecom Index and assumes the reinvestment of any dividends. The stockholder return shown on the graph below should not be considered indicative of future stockholder returns and the Company will not make or endorse any predictions as to future stockholder returns.

### COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\*

Among Novatel Wireless, Inc., The NASDAQ Composite Index  
And The NASDAQ Telecommunications Index



\* \$100 invested on 12/31/01 in stock or index-including reinvestment of dividends.  
Fiscal year ending December 31.

	Cummulative Total Return					
	12/01	12/02	12/03	12/04	12/05	12/06
<b>Novatel Wireless, Inc.</b>	<b>100.00</b>	<b>5.30</b>	<b>32.73</b>	<b>106.07</b>	<b>66.17</b>	<b>52.84</b>
<b>NASDAQ Composite</b>	<b>100.00</b>	<b>68.85</b>	<b>101.86</b>	<b>112.16</b>	<b>115.32</b>	<b>127.52</b>
<b>NASDAQ Telecommunications</b>	<b>100.00</b>	<b>61.62</b>	<b>110.79</b>	<b>106.16</b>	<b>100.63</b>	<b>127.11</b>

**Item 6. Selected Financial Data**

The following selected financial data should be read in conjunction with our Consolidated Financial Statements and the related notes and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” appearing elsewhere in this Form 10-K. The selected consolidated statement of operations data presented below for each of the years ended December 31, 2006, 2005, and 2004, and the consolidated balance sheet data at December 31, 2006 and 2005 are derived from our Consolidated Financial Statements that have been included elsewhere in this Form 10-K. The selected consolidated statement of operations data for the years ended December 31, 2003 and 2002 and consolidated balance sheet data at December 31, 2004, 2003, and 2002 are derived from audited consolidated financial statements not included in this Form 10-K.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(in thousands, except per share data)				
<b>Consolidated Statements of Operations Data:</b>					
Revenue	\$ 217,972	\$ 161,736	\$ 103,727	\$ 33,815	\$ 28,872
Cost of revenue	162,749	115,568	69,780	27,942	27,257
Gross margin	55,223	46,168	33,947	5,873	1,615
Operating expenses:					
Research and development	31,317	20,515	10,625	6,118	13,723
Sales and marketing	14,168	7,611	4,739	2,693	4,956
General and administrative	16,306	7,528	5,138	4,068	8,287
Restructuring and impairment charges	—	—	—	828	2,650
Total operating expenses	61,791	35,654	20,502	13,707	29,616
Income (loss) from operations	(6,568)	10,514	13,445	(7,834)	(28,001)
Other income (expense), net	4,305	2,008	723	(3,804)	(317)
Income (loss) before income taxes	(2,263)	12,522	14,168	(11,638)	(28,318)
Provision (benefit) for income taxes	(2,706)	1,406	349	—	—
Net income (loss) after income taxes	443	11,116	13,819	(11,638)	(28,318)
Net income (loss) applicable to common stockholders	\$ 443	\$ 11,116	\$ 13,674	\$ (16,717)	\$ (53,481)
Net income (loss) per common share:					
Basic	\$ 0.01	\$ 0.38	\$ 0.57	\$ (2.14)	\$ (10.47)
Diluted	\$ 0.01	\$ 0.37	\$ 0.48	\$ (2.14)	\$ (10.47)
Weighted average shares outstanding:					
Basic	29,580	29,132	23,969	7,818	5,107
Diluted	30,058	30,319	28,863	7,818	5,107
			December 31,		
	2006	2005	2004	2003	2002
	(in thousands)				
<b>Consolidated Balance Sheets Data:</b>					
Cash and cash equivalents and marketable securities	\$ 84,162	\$ 90,339	\$ 81,221	\$ 4,577	\$ 1,676
Working capital (deficiency)	107,985	95,050	62,828	2,258	(2,143)
Total assets	191,645	176,064	116,323	24,421	24,047
Long-term obligations, net of current portion	—	—	—	—	38
Convertible and redeemable preferred stock	—	—	—	—	665
Stockholders’ equity	134,236	121,059	100,178	8,990	6,501

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

The following discussion of our consolidated financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements and related notes included elsewhere in this report. This report contains certain forward-looking statements relating to future events or our future financial performance. These statements are subject to risks and uncertainties which could cause actual results to differ materially from those discussed in this report. You are cautioned not to place undue reliance on this information which speaks only as of the date of this report. We are not obligated to publicly update this information, whether as a result of new information, future events or otherwise, except to the extent we are required to do so in connection with our obligation to file reports with the SEC. For a discussion of the important risks related to our business and future operating performance, see the discussion under the caption "Item 1A. Risk Factors" and under the caption "Factors Which May Influence Future Results of Operations" below. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur.

**Overview and Background**

We are a provider of wireless broadband access solutions for the worldwide mobile communications market. Our broad range of products includes 3G wireless PC card and ExpressCard modems, embedded modems, communications software and FMC solutions for wireless network operators, infrastructure providers, distributors, OEMs and vertical markets worldwide. Through the integration of our hardware and software, our products are designed to operate on a majority of global wireless networks and provide mobile subscribers with secure and convenient high speed access to corporate, public and personal information through the Internet and enterprise networks. We also offer software engineering, integration and design services to our customers to facilitate the use of our products.

Our strong customer relationships provide us with the opportunity to expand our market reach and sales. Most of our sales to wireless operators and OEMs are sold directly through our sales force. To a lesser degree, we also use an indirect sales distribution model through the use of select distributors. We are continuing to drive widespread adoption of our products through increased global marketing activities, expansion of our sales team and distribution networks and continued leverage of our strategic relationships with wireless industry leaders.

We intend to continue to identify and respond to our customers' needs by introducing new product designs with an emphasis on supporting cutting edge WAN technology, ease-of-use, performance, size, weight, cost and power consumption. We manage our products through a structured life cycle process, from identifying initial customer requirements through development and commercial introduction to eventual phase-out. During product development, emphasis is placed on time-to-market, meeting industry standards and customer product specifications, ease of integration, cost reduction, manufacturability, quality and reliability.

We have agreements with LG Innotek and IAC for the outsourced manufacturing of our products. Under our manufacturing agreements, LG Innotek and IAC provide us with services including component procurement, product manufacturing, final assembly, testing, quality control, fulfillment and delivery services. In addition, we have an agreement with Mobiltron for certain distribution and fulfillment services related to our business in Europe, Middle East, and Africa, or EMEA.

**Factors Which May Influence Future Results of Operations**

We have entered into and expect to continue to enter into new customer contracts for the development and supply of our products and this may place significant demands on our resources.

*Revenue.* We believe that our revenue growth will be influenced largely by the speed and breadth of the increase in demand for wireless access to data through the use of next generation networks including demand for 3G products and 3G data access services, particularly in Europe, North America and Asia; customer acceptance

for our new products that address these markets; and our ability to meet customer demand. Factors that could potentially affect customer demand for our products include the following:

- demand for broadband access services and networks;
- use of the Internet;
- rate of change to new products;
- loss of significant customers;
- increase in competition;
- timing of deployment of 3G networks by carriers;
- drop in demand for EV-DO, UMTS and HSDPA products; and
- changes in technologies.

We began shipping our first 3G products in December 2003. We have shipped 14 new 3G products since then and anticipate introducing additional 3G products during 2007. We continue to develop and maintain strategic relationships with wireless and computing industry leaders like Alcatel, Siemens, Dell, QUALCOMM, Sprint PCS, Verizon Wireless and Vodafone and major software vendors. Through strategic relationships, we have been able to increase market penetration by leveraging the resources of our channel partners, including their access to distribution resources, increased sales opportunities and market opportunities.

Our strategic relationships include technology and marketing relationships with wireless operators, OEM customers that integrate our products into other devices, distributors and leading hardware and software technology providers.

*Cost of Revenue.* We currently outsource our manufacturing operations to LG Innotek and IAC. In addition, we currently outsource certain distribution and fulfillment services related to our business in EMEA to Mobiltron. All costs associated with these manufacturers and Mobiltron are included in our cost of revenue. Cost of revenue also includes warranty costs, amortization of intangible licenses, royalties based on a percentage of revenue, operations group expenses, costs related to development services and costs related to inventory adjustments, including write downs for excess and obsolete inventory. Inventory adjustments are impacted primarily by demand for our products, which is influenced by the factors discussed above. During 2006, 2005 and 2004, we recorded inventory write downs of \$2.9 million, \$2.9 million and \$100,000, respectively, primarily due to the decrease in demand for the affected products. We expect to continue to outsource our manufacturing operations, and as our business grows we expect our manufacturing activity to increase.

*Operating Expenses.* Many of our products target wireless operators and other customers in Europe, North America and Asia. If these markets continue to grow, we will likely develop new products to serve these markets, resulting in increased research and development expenses associated with such new product development. We have in the past and expect to continue to incur these expenses in future periods prior to recognizing revenue from these contracts. The accounting for stock options began in the first quarter of 2006 and required us to use the fair value method to account for all stock-based compensation pursuant to Statement of Financial Accounting Standard, or SFAS, No. 123(R), which significantly increased our operating expenses.

#### **Critical Accounting Policies and 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. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues, expenses and disclosures of contingent assets and liabilities. Actual results could differ from these estimates. Critical accounting policies and significant estimates include revenue recognition, allowance for doubtful accounts receivable, provision for excess and

obsolete inventory, useful lives, valuation of intangible and long-lived assets, provision for warranty costs, royalty accruals, deferred tax asset valuation allowance, foreign exchange forward contracts, and share-based compensation expense.

*Revenue Recognition.* Our revenue is generated from the sale of wireless modems to wireless operators, OEM customers and distributors, and, to a lesser extent, from development services contracts. Revenue from product sales is recognized upon the latest of transfer of title or shipment of the product to the customer. For product sales with acceptance provisions, revenue is recognized at such time that the acceptance provisions are satisfied. We grant price protection provisions to certain customers and track pricing and other terms offered to customers buying similar products to assess compliance with these provisions. We establish allowances for estimated product returns and price protection in the period in which revenue is recognized. In estimating future product returns, we consider various relevant factors, including our stated return policies and practices, and historical trends. We recognize revenue in accordance with Staff Accounting Bulletin, or SAB, No. 101, "Revenue Recognition in Financial Statements," as amended by SAB No. 104, which provides guidance on the application of generally accepted accounting principles to selected revenue recognition issues.

During 2003, we amended a joint development agreement containing multiple elements with one of our customers including development services and product shipments. Accordingly, we separated the deliverables into units of accounting and allocated arrangement consideration to these deliverables in accordance with the provisions of Emerging Issues Task Force, or EITF, Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." In accordance with EITF Issue No. 00-21, \$6.2 million in cash payments received in 2003 was deferred and was recognized as revenue when products were shipped or as development services were performed. During 2004, we recognized approximately \$5.7 million of this deferred revenue and the remaining \$531,000 was recognized during the first quarter of 2005. We do not expect development services revenue to represent a significant percentage of total revenue in the foreseeable future.

*Allowance for Doubtful Accounts Receivable.* We provide an allowance for our accounts receivable for estimated losses that may result from our customers' inability to pay. We determine the amount of the allowance by analyzing known uncollectible accounts, aged receivables, economic conditions, historical losses, and changes in customer payment cycles and our customers' credit-worthiness. Amounts later determined and specifically identified to be uncollectible are charged or written off against this allowance. To minimize the likelihood of uncollectibility, we review our customers' credit-worthiness periodically based on credit scores generated by independent credit reporting services, our experience with our customers and the economic condition of our customers' industries. Material differences may result in the amount and timing of expense for any period if we were to make different judgments or utilize different estimates. If the financial condition of our customers deteriorates resulting in an impairment of their ability to make payments, additional allowances may be required. We have not experienced significant variances in the past between our estimated and actual allowance for doubtful accounts and anticipate that we will be able to continue to make reasonable estimates in the future.

*Provision for Excess and Obsolete Inventory.* Inventories are stated at the lower of cost (first-in, first-out method) or market. We review the components of our inventory and our inventory purchase commitments on a regular basis for excess and obsolete inventory based on estimated future usage and sales. Write-downs in inventory value depend on various items, including factors related to customer demand as discussed under "Revenue" above, economic and competitive conditions, technological advances or new product introductions by us or our customers that vary from our current expectations. Whenever inventory is written down a new cost basis is established and the inventory is not subsequently written up if market conditions improve.

We believe that, when made, the estimates we use in calculating the inventory provision are reasonable and properly reflect the risk of excess and obsolete inventory. If customer demand for our inventory is substantially less than our estimates, inventory write-downs may be required, which could have a material adverse effect on our consolidated financial statements.

*Valuation of Intangible and Long-Lived Assets.* We periodically assess the valuation of intangible and long-lived assets, which requires us to make assumptions and judgments regarding the carrying value of these assets. We consider assets to be impaired if the carrying value may not be recoverable based upon our assessment of the following events or changes in circumstances: the asset's ability to continue to generate income from operations and positive cash flow in future periods; loss of legal ownership or title to the asset; significant changes in our strategic business objectives and utilization of the asset; or significant negative industry or economic trends.

Our assessment includes comparing the carrying amounts of intangible and long-lived assets to their fair values, which are determined using a discounted cash flow model. This model requires estimates of our future revenues, profits, capital expenditures, working capital and other relevant factors. We estimate these amounts by evaluating our historical trends, current budgets, operating plans and other industry data. If the assets are considered to be impaired, the impairment charge recognized is the amount by which the asset's carrying value exceeds its estimated fair value.

The timing and frequency of our impairment test is based on an ongoing assessment of triggering events that could reduce the fair value of our long-lived assets below their carrying value. We monitor our intangible and long-lived asset balances and conduct formal tests on at least an annual basis or earlier when impairment indicators are present. We believe that the assumptions and estimates we used to value intangible and long-lived assets were appropriate based on the information available to management. The majority of our long-lived assets are being amortized or depreciated over relatively short periods, typically three to five years. This reduces the risk of large impairment charges in any given period. However, most of these assets are associated with technology that changes rapidly and such changes could have an immediate impact on our impairment analysis.

*Warranty Costs.* We accrue warranty costs based on estimates of future warranty related replacement, repairs or rework of products. Our warranty policy generally provides one to three years of coverage for products following the date of purchase. Our policy is to accrue the estimated cost of warranty coverage as a component of cost of revenue in the accompanying consolidated statements of operations at the time revenue is recognized. In estimating our future warranty obligations we consider various relevant factors, including the historical frequency and volume of claims, and the cost to replace or repair products under warranty. The warranty provision for our products is determined by using a financial model to estimate future warranty costs. Our financial model takes into consideration actual product failure rates; estimated replacement, repair or rework expenses; and potential risks associated with our different products. The risk levels, warranty cost information, and failure rates used within this model are reviewed throughout the year and updated, if and when, these inputs change.

We actively engage in product improvement programs and processes to limit our warranty costs, but our warranty obligation is affected by the complexity of our product, product failure rates and costs incurred to correct those product failures. The industry in which we operate is subject to rapid technological change, and as a result, we periodically introduce newer, more complex products. We have not experienced significant variances in the past between our estimated and actual warranty costs. Depending on the quality of our product design and manufacturing, actual product failure rates or actual warranty costs could be materially different than our estimates, which could harm our financial condition and results of operations.

*Royalty Costs.* We have intellectual property license agreements which generally require us to make royalty payments based on a percentage of the revenue generated by sales of products incorporating the licensed technology. We recognize royalty obligations in accordance with the terms of the respective royalty agreements. We have also accrued for estimated royalty costs in situations where we do not have agreements based upon our current best estimate of the royalty obligation. These estimates are based on various market data information and other relevant information. If we enter into such agreements, or when additional market data becomes available, we will revise our estimates if necessary.

*Income Taxes.* We recognize federal, state and foreign current tax liabilities or assets based on our estimate of taxes payable to or refundable by tax authorities in the current fiscal year. We also recognize federal, state and foreign deferred tax liabilities or assets based on our estimate of future tax effects attributable to temporary differences and carry forwards and record a valuation allowance to reduce any deferred tax assets by the amount of any tax benefits that, based on available evidence and judgment, are not expected to be realized. During 2006 and 2005, we recorded a non-cash deferred income tax benefit of \$2.8 million and \$2.4 million, respectively, for the reversal of the valuation allowance on certain deferred tax assets. See further discussion in Note 7 to our consolidated financial statements. We will continue to evaluate the necessity of the valuation allowance based on the remaining deferred tax assets.

*Foreign Exchange Forward Contracts.* We use foreign exchange forward contracts to hedge the economic exposure associated with accounts receivable balances denominated in Euros. Our forward contracts do not qualify as accounting hedges. We mark-to-market the forward contracts and include unrealized gains and losses in the current period as a component of other income (expense). During 2006, 2005 and 2004, we recorded unrealized losses of approximately \$1.4 million, \$1.8 million and \$132,000, respectively, on our forward contracts. These unrealized losses were offset by foreign currency gains of approximately \$2.8 million, losses of approximately \$2.1 million, and losses of approximately \$65,000, respectively, recorded in other income and expense. As of December 31, 2006, the total amount of outstanding forward contracts amounted to 12 million Euros.

*Share-based Compensation.* We grant stock options and restricted stock to our employees and non-employee directors under our current stock plan. The benefits provided under this plan are share-based payments subject to the provisions of SFAS No. 123(R). Effective January 1, 2006, we adopted the requirements of SFAS No. 123(R) which addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. As a result of this new accounting requirement, our consolidated financial statements for the year ended December 31, 2006 include compensation expense as calculated per the provisions of SFAS No. 123(R). In adopting SFAS No. 123(R), we elected to use the modified prospective transition method, thus our consolidated financial statements for periods prior to January 1, 2006 do not include any impact of SFAS No. 123(R). We also elected to attribute the value of share-based compensation to expense using the straight-line method for awards granted after December 31, 2005 upon our adoption of SFAS No. 123(R). Share-based compensation expense for awards outstanding as of December 31, 2005 are being recognized over the remaining service period using the compensation expense calculated according to the pro forma disclosure provisions under SFAS No. 123, which uses the straight-line expense recognition method for those awards with a graded vesting schedule. Share-based compensation expense related to stock options, our ESPP and restricted stock was \$10.0 million for the year ended December 31, 2006.

Upon adoption of SFAS No. 123(R) on January 1, 2006, we elected to value our share-based payment option awards using the Black-Scholes option pricing model as we had under the pro forma provisions of SFAS No. 123. The determination of fair value of share-based awards on the date of grant is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These significant assumptions include our expected stock price volatility over the term of the awards and the expected term of stock options.

We determined our expected volatility by using a combination of historical and implied volatility, or blended volatility, to derive our expected volatility assumption as allowed under SFAS No. 123(R) and SAB No. 107. Implied volatility was based on three-month traded options of our common stock. We determined that the volatility calculated using a blend of implied volatility and our historical volatility was more reflective of expected volatility than using only historical volatility. The expected term of stock options represents the weighted-average period the stock options are expected to remain outstanding. The expected term of options granted is estimated using the average of the vesting date, the contractual term and historical experience.

Other assumptions required for estimating fair value under the Black-Scholes option pricing model are the expected risk-free interest rate and expected dividend yield of our stock. Our risk-free interest rate assumption is

based upon currently available rates on zero coupon U.S. Government issues for the expected term of our stock options. The expected dividend rate is not applicable to us as we have not historically declared or paid dividends nor do we currently anticipate paying cash dividends in the foreseeable future.

SFAS No. 123(R) also requires forfeitures to be estimated at the time of grant and we have estimated our forfeitures based on historical experience. We will revise this estimate, if necessary, in subsequent periods if actual forfeiture rates differ from our estimates. In our pro forma information required under SFAS No. 123 for periods prior to January 1, 2006, we accounted for forfeitures as they occurred.

If we change any of the critical assumptions that we use in the Black-Scholes option pricing model such as expected volatility or expected term or if we decide to use a different valuation model in the future, the compensation expense that we record under SFAS No. 123(R) may differ significantly in the future from what we have recorded in the current period. In addition, as the guidance by regulators for SFAS No. 123(R) is relatively new, the application of these principles may be subject to further interpretation and refinement over time.

### **New Accounting Pronouncements**

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Instruments.* SFAS No. 155 amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging* and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole, eliminating the need to bifurcate the derivative from its host, if the holder elects to account for the whole instrument on a fair value basis. In addition, among other changes, SFAS No. 155 (i) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; (ii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; (iii) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (iv) eliminates the prohibition on a qualifying special-purpose entity (“QSPE”) from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial interest. SFAS No. 155 will be applied prospectively and is effective for all financial instruments acquired or issued for fiscal years beginning after September 15, 2006. SFAS No. 155 is not expected to have a material impact on our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, or FIN 48, which is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainties in income taxes recognized in accordance with SFAS No. 109, *Accounting for Income Taxes* by prescribing guidance for the recognition, derecognition and measurement in financial statements of income tax positions taken in previously filed tax returns or tax positions expected to be taken in tax returns, including a decision whether to file or not to file in a particular jurisdiction. FIN 48 requires that any liability created for unrecognized tax benefits be disclosed. The application of FIN 48 may also affect the tax bases of assets and liabilities and therefore may change or create deferred tax liabilities or assets. The Company will be required to adopt FIN 48 as of January 1, 2007. If there are changes in the net assets of the Company as a result of the application of FIN 48, the cumulative effects, if any, will be recorded as an adjustment to retained earnings. We are currently evaluating the impact of adoption of FIN 48 and have not yet determined the effect on our earnings or financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which is effective for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value using generally accepted accounting principles, and expands disclosures related to fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements.

However, for some entities, the application of this Statement will change current practice. This Statement is effective for us on January 1, 2008. We are currently evaluating the impact of adoption of SFAS No. 157 and have not yet determined the effect on our earnings or financial position.

## Results of Operations

The following table sets forth our consolidated statements of operations expressed as a percentage of revenue for the periods indicated.

	Year Ended December 31,		
	2006	2005	2004
	(as a percent of revenue)		
Revenue	100.0%	100.0%	100.0%
Cost of revenue	74.7	71.5	67.3
Gross margin	25.3	28.5	32.7
Operating expenses:			
Research and development	14.4	12.7	10.2
Sales and marketing	6.5	4.7	4.5
General and administrative	7.4	4.7	5.0
Total operating expenses	28.3	22.1	19.7
Income (loss) from operations	(3.0)	6.4	13.0
Interest income	1.4	1.4	0.8
Interest expense	(0.1)	0.0	(0.1)
Other income (expense), net	0.7	(0.1)	(0.1)
Income (loss) before income taxes	(1.0)	7.7	13.6
Provision (benefit) for income taxes	(1.2)	0.8	0.3
Net income after income taxes	0.2%	6.9%	13.3%

### Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

**Revenue.** Revenue for the year ended December 31, 2006 increased \$56.3 million, or 34.8%, to \$218.0 million compared to \$161.7 million for 2005. The overall increase in revenue was primarily attributable to an increase in demand for our EV-DO products, which includes our EV-DO ExpressCard and EV-DO Fixed Mobile Convergence products that were introduced in the second half of 2006. The increase in EV-DO product sales for the year ended December 31, 2006 compared to 2005 was approximately \$80.8 million. Our UMTS / HSDPA product sales decreased by approximately \$24.0 million during 2006 compared to 2005. The decrease in sales of our UMTS / HSDPA products was the result of a technology transition from UMTS to HSDPA during 2006. The overall decrease in UMTS / HSDPA revenue was partially offset by strong sales of our HSDPA ExpressCards and HSDPA Embedded Modules which were introduced during the second half of 2006. Overall, EV-DO revenue, which consists primarily of North American products, represented approximately 66% of revenue in 2006 compared to 40% in 2005 while UMTS / HSDPA products represented approximately 34% of revenue in 2006 compared to 60% in 2005.

There was no revenue recognized from development services during the year ended December 31, 2006 compared to approximately \$500,000 for 2005.

**Cost of revenue.** Cost of revenue for the year ended December 31, 2006 increased \$47.2 million, or 40.8%, to \$162.7 million compared to \$115.6 million in 2005. The increase in cost of revenue was primarily related to an increase of product cost of \$31.2 million due to the increase in product sales and additional costs

associated with new products introduced, as discussed above. In addition, freight and distribution costs increased by approximately \$6.2 million due to the additional volume of products shipped in 2006 compared to 2005. The remaining increase in costs of revenue primarily consists of an increase in royalty costs for intellectual property licenses of \$6.7 million, a \$2.4 million increase in warranty costs, and an increase in manufacturing overhead costs of approximately \$700,000 during 2006 compared to 2005. In addition, cost of revenue was negatively impacted by approximately \$500,000 of share-based compensation expense recorded during the year ended December 31, 2006 related to the adoption of SFAS No. 123R.

**Gross margin.** Gross margin for the year ended December 31, 2006 increased by \$9.0 million, or 19.5%, to \$55.2 million compared to \$46.2 million for 2005. The increase was primarily attributable to the increase in revenue as discussed above. Gross margin as a percent of revenue decreased to 25.3% for the year ended December 31, 2006 compared to 28.5% for 2005. The decrease in gross margin as a percentage of revenue was attributable to additional costs incurred for new products introduced during the year, recognition of SFAS No. 123R share-based compensation expense, and sales of products with lower margins in 2006 as compared to 2005.

**Research and development expenses.** Research and development expenses for the year ended December 31, 2006 increased \$10.8 million, or 52.7%, to \$31.3 million compared to \$20.5 million for 2005. The increase was primarily attributable to an increase of \$7.7 million in salary and related expenses, which includes \$2.3 million of share-based compensation in connection with the adoption of SFAS No. 123R. Other increases consist of depreciation expenses of approximately \$1.5 million due to capital equipment purchases, increase in outside consulting services of approximately \$1.0 million, and an increase of approximately \$400,000 in facility expenses as compared to 2005. In addition, there were no costs recovered from customer funded development contracts compared to approximately \$200,000 recovered in 2005.

**Sales and marketing expenses.** Sales and marketing expenses for the year ended December 31, 2006 increased \$6.6 million, or 86.1%, to \$14.2 million compared to \$7.6 million for 2005. The increase was primarily attributable to an increase in sales and marketing efforts which included hiring new personnel during 2006 primarily to expand our European sales team resulting in increased salary and related expenses of \$4.3 million, which includes \$2.0 million of share-based compensation expense related to the adoption of SFAS No. 123R. In addition, product marketing and advertising expenses increased \$1.6 million, leasehold expenses increased \$400,000, and travel and related expenditures increased \$300,000 in 2006 compared to 2005.

**General and administrative expenses.** General and administrative expenses for the year ended December 31, 2006 increased \$8.8 million, or 117.3%, to \$16.3 million compared to \$7.5 million for the same period in 2005. The increase was primarily attributable to an increase in salary and related expenses of \$6.5 million, which includes \$5.3 million of share-based compensation expense related to the adoption of SFAS No. 123R. General and administrative expenses also include an increase in professional service and legal fees of approximately \$800,000, an increase in depreciation and amortization expenses of approximately \$800,000, and an increase in bad debts expense of approximately \$700,000 during 2006 as compared to 2005.

**Other income (expense).** Other income (expense) for the year ended December 31, 2006 increased by approximately \$2.3 million, or 114%, to \$4.3 million compared to \$2.0 million for the same period in 2005. This increase was primarily due to the increase in our foreign exchange gains on our Euro denominated receivable and cash balances.

**Provision for Income Taxes.** We recorded an income tax benefit of approximately \$2.7 million for the year ended December 31, 2006. The income tax benefit and related deferred tax asset recorded during 2006 was primarily due to a revision of our valuation allowance on specific Canadian and U.S. deferred tax assets of approximately \$2.8 million. During 2006, management evaluated the deferred tax valuation allowance and determined that the valuation allowance on a portion of the Canadian and U.S. deferred tax assets should be revised and as a result, the Company recorded a non-cash deferred income tax benefit to the statements of

operations of \$2.8 million for the year ended December 31, 2006. This determination was based on 2004, 2005 and 2006 operating results and in anticipation of using net operating losses due to current projections of future taxable income. The effective tax rate for the year ended December 31, 2006 was approximately negative 3%, excluding the valuation allowance revision. The difference between the federal and state statutory combined rate of 40% and our effective tax rate for 2006 is primarily due to the impact of accounting for share-based compensation, for which certain share-based awards are treated as permanent differences.

For 2005, income tax expense was approximately \$1.4 million, which consists of federal and state taxes at our estimated effective tax rate of 31% offset by a revision of our valuation allowance on specific U.S. deferred tax assets of approximately \$2.4 million. The difference between the federal and state statutory rate of approximately 40% and our effective tax rate is due primarily to research and development credits generated in 2005 and a low effective state tax rate.

In accordance with SFAS No. 123(R), we recognize a tax benefit upon expensing certain share-based awards associated with our share-based compensation plans, including nonqualified stock options and restricted stock, but under current accounting standards we cannot recognize a tax benefit currently for those share-based compensation expenses associated with incentive stock options and employee stock purchase plan shares (qualified stock options). For qualified stock options that vested after our adoption of SFAS No. 123(R), we recognize a tax benefit only in the period when disqualifying dispositions of the underlying stock occur, and for qualified stock options that vested prior to our adoption of SFAS No. 123(R), the tax benefit is recorded directly to additional paid-in capital. During 2006, we recorded a tax benefit of approximately \$2.6 million associated with total share-based compensation. The impact of share-based compensation permanent items resulted in an increase of 44 percentage points to the annual effective tax rate. Because we cannot recognize the tax benefit for share-based compensation expense associated with qualified stock options until the occurrence of future disqualifying dispositions of the underlying stock and because a portion of that tax benefit may be recorded directly to additional paid-in capital, our future quarterly and annual effective tax rates will be subject to greater volatility and, consequently, our ability to reasonably estimate our future quarterly and annual effective tax rates is diminished.

**Net income.** For the year ended December 31, 2006, the Company reported net income available to common stockholders of approximately \$400,000, which includes non-cash share-based compensation expense of approximately \$7.4 million after tax, as compared to net income of \$11.1 million in 2005.

#### **Year Ended December 31, 2005 Compared to Year Ended December 31, 2004**

**Revenue.** Revenue for the year ended December 31, 2005 increased \$58.0 million, or 55.9%, to \$161.7 million compared to \$103.7 million in 2004. The overall increase in revenue is primarily attributable to an increase in product sales of approximately \$61.5 million primarily due to strong demand for our UMTS U630 and EV-DO PC cards, which were both introduced during the fourth quarter of 2004. The overall increase in CDMA / EV-DO product sales in 2005 was approximately \$45.5 million. Our UMTS / HSDPA product sales, which include the Fixed Mobile Convergence products that were introduced during the first quarter of 2005, increased by approximately \$16.0 million in 2005 compared to 2004. The increase in revenue was also attributable to the overall increase in demand for our wireless products and wireless access services, which is the direct result of the continued deployment of 3G networks throughout Europe, North America, Asia and Africa. Revenue recognized for development services decreased by \$3.5 million, or 87.5%, to \$500,000 during 2005 as compared to \$4.0 million in 2004. We do not expect development services revenue to represent a significant percentage of total revenue in the foreseeable future.

**Cost of revenue.** Cost of revenue for the year ended December 31, 2005 increased by \$45.8 million, or 65.6%, to \$115.6 million compared to \$69.8 million in 2004. The increase in cost of revenues was primarily related to an increase in product cost of \$39.2 million due to the increase in revenues as discussed above. In addition, freight and distribution costs increased by approximately \$3.7 million due to additional costs associated

with our European product sales. The remaining increases in costs of sales consisted of an increase of approximately \$2.8 million related to the write-off of certain legacy products in inventory and an increase in royalty costs of approximately \$2.7 million. The cost of revenues was favorably impacted by a decrease in development service costs from \$2.9 million in 2004 to \$200,000 in 2005.

**Gross margin.** Gross margin for the year ended December 31, 2005 increased by \$12.2 million, or 36%, to \$46.2 million compared to \$33.9 million in 2004. The increase was primarily attributable to the increase in sales volume of our products. Gross margin as a percentage of revenue decreased to 28.5% for the year ended December 31, 2005 compared to 32.7% for 2004. The decrease in gross margin as a percentage of revenue was primarily attributable to the negative impact of competitive pricing pressures on our sales prices in Europe, write-offs of inventory as discussed above, and the additional freight and distribution costs associated with our move towards a direct distribution model in Europe in 2005.

**Research and development expenses.** Our research and development expenses for the year ended December 31, 2005 increased \$9.9 million, or 93.1%, to \$20.5 million compared to \$10.6 million for the same period in 2004. Research and development expenses increased as a result of additional staff and products developed in 2005 compared to 2004. This increase was primarily attributable to an increase of approximately \$2.8 million in salary and related expenses due to additional headcount, an increase in outside consulting services and travel costs of approximately \$1.7 million, an increase of \$1.6 million in research supplies and expendable equipment due to increased product development activities in 2005 as compared to 2004, an increase in facility and depreciation expenses of approximately \$1.0 million due to facility expansions and capital equipment purchases. In addition, costs recovered from customer funded development contracts decreased by \$2.7 million, to \$200,000, compared to \$2.9 million for 2004.

**Sales and marketing expenses.** Sales and marketing expenses for the year ended December 31, 2005 increased \$2.9 million, or 60.6%, to \$7.6 million compared to \$4.7 million for the same period in 2004. The increase was primarily a result of an increase in sales and marketing efforts, which included hiring new personnel during 2005 to expand our European sales team, which increased salary and related expenses by approximately \$1.6 million, an increase in marketing expenses of approximately \$500,000, an increase in rent and utilities expense of \$400,000 due primarily to facility expansions and an increase in travel costs of approximately \$300,000 compared to 2004.

**General and administrative expenses.** General and administrative expenses for the year ended December 31, 2005 increased approximately \$2.4 million, or 46.5%, to \$7.5 million compared to \$5.1 million for the same period in 2004. The increase was primarily attributable to an increase in professional fees of approximately \$1.4 million due largely to costs associated with complying with the requirements of Sarbanes-Oxley as well as tax accounting fees associated with consulting services related to evaluating our ability to utilize our net operating losses, and an increase in salary and related expenses of approximately \$1.0 million due to additional headcount during 2005 as compared to 2004.

**Interest income and expense.** Interest income and expense increased by approximately \$1.3 million for the year ended December 31, 2005 compared to the same period in 2004 primarily due to the increase in our average cash and marketable securities balances in 2005, as well as an increase in the average yields realized on our marketable securities and cash balances, which resulted in higher income yielded as compared to 2004.

**Provision for income taxes.** Income tax expense was approximately \$1.4 million for 2005, which consists of federal and state taxes at our estimated effective tax rate of 31% offset by a revision of our valuation allowance on specific U.S. deferred tax assets of approximately \$2.4 million. During 2005, management evaluated the deferred tax valuation allowance and determined that the valuation allowance on a portion of the U.S. deferred tax assets should be revised and as a result, the Company recorded a non-cash deferred income tax benefit to the Statements of Operations of \$2.4 million for the year ended December 31, 2005. This determination was based on 2004 and 2005 operating results and in anticipation of using net operating losses due

to current projections of future taxable income. In addition, we recorded a credit of \$8.2 million to Stockholders' Equity relating to the reduction of the valuation allowance on net operating loss carryforwards from stock option deductions.

The difference between the federal and state statutory rate of approximately 40% and our effective tax rate is due primarily to research and development credits generated in 2005 and a low effective state tax rate.

**Net income.** For the year ended December 31, 2005, the Company reported net income available to common stockholders of \$11.1 million as compared to \$13.7 million for the same period in 2004.

### **Liquidity and Capital Resources**

As of December 31, 2006, we had working capital of \$108.0 million and \$84.2 million in cash and cash equivalents and short-term and long-term marketable securities, which is a decrease of \$6.1 million from \$90.3 million at December 31, 2005.

For the years ended December 31, 2006, and 2005, we recorded net income available to common stockholders of \$443,000 and \$11.1 million, respectively. As of December 31, 2006, we had an accumulated deficit of \$221.9 million compared to an accumulated deficit of \$222.3 million at December 31, 2005.

On December 29, 2005, we entered into a two-year \$25.0 million secured revolving credit facility ("the Credit Agreement"). The Credit Agreement was entered into with Bank of America, N.A., as Administrative Agent, who was granted a first priority blanket lien on substantially all of our assets in order to secure repayment of outstanding indebtedness under the Credit Agreement. At the Company's option, borrowings under the Credit Agreement will bear interest at either London Interbank Offering Rate (LIBOR) plus 100-150 basis points depending on the level of borrowing under the Credit Agreement, or at the prime rate plus 50 basis points (8.75% at December 31, 2006). As of December 31, 2006 and 2005, we had zero and \$5.0 million, respectively, outstanding under the Credit Agreement.

In May 2004, we completed an underwritten equity offering transaction, raising approximately \$61.0 million, net of offering costs and underwriters' commissions of approximately \$4.9 million, upon the issuance of 4,250,000 shares of our common stock.

In January 2004, we raised aggregate net proceeds of approximately \$7.5 million, net of fees to the placement agent and offering costs, from the issuance of 1,142,855 shares of common stock in a private placement transaction with accredited investors. Warrants to acquire 228,565 common shares at a price of \$8.83 per share, expiring on January 15, 2009, were also issued in conjunction with this offering.

During 2006 and 2005, we received aggregate proceeds of approximately \$1.0 million and \$1.0 million in connection with the issuance of 337,936 and 327,344 shares of common stock, respectively, upon the exercise of certain outstanding warrants and stock options.

#### *Historical Cash Flows*

**Net cash provided by operating activities.** Net cash provided by operating activities decreased by \$3.9 million to \$8.6 million for 2006 compared to \$12.5 million for 2005. This decrease was primarily attributable to an increase in our accounts receivable of \$20.3 million and an increase in inventory of \$5.5 million, offset by an increase in prepaid expenses of \$6.5 million, an increase in our accounts payable of \$5.1 million, an increase in other accrued expenses of \$6.3 million and net income for 2006 of approximately \$443,000, which includes \$10.0 million of non-cash share-based compensation expense, \$8.0 million of non-cash depreciation and amortization expenses, \$2.9 million of inventory write-offs, and \$4.7 million of non-cash change in deferred taxes. Net cash provided by operating activities for 2005 was approximately \$12.5 million.

This was primarily attributable to \$11.1 million net income recorded for the fiscal year ended December 31, 2005, compared to our net income of \$13.8 million in 2004.

**Net cash used in investing activities.** Net cash used in investing activities for 2006 was approximately \$4.2 million compared to \$3.9 million provided by investing activities in 2005. The cash used in investing activities in 2006 was primarily due to purchases of property and equipment of \$8.1 million and purchases of licensed technologies of approximately \$500,000, offset by the sales of marketable securities of \$4.5 million. The cash provided by investing activities in 2005 was primarily due to the net sales of marketable securities of \$11.0 million, offset by purchases of property and equipment of \$6.8 million and purchases of licensed technologies of approximately \$400,000.

**Net cash used from financing activities.** Net cash used in financing activities for 2006 was \$6.5 million, compared to net cash provided by financing activities of \$3.8 million for 2005. Cash used in financing activities in 2006 was primarily due to the settlement of our outstanding balance on our line of credit facility of \$5.0 million and \$3.9 million payment on our capital lease obligations, offset by \$1.0 million of proceeds received from the exercise of common stock options and warrants, proceeds of \$700,000 received from the issuance of common stock under the employee stock purchase plan, and non-cash excess tax benefits from stock option exercises of approximately \$700,000. Cash provided by financing activities in 2005 was due to proceeds from borrowings on our line of credit facility of \$5.0 million, \$1.0 million of proceeds received from the exercise of common stock options, and proceeds of \$500,000 received from the issuance of common stock under the employee stock purchase plan, offset by payments of approximately \$2.8 million under capital lease obligations.

#### *Contractual Obligations and Commercial Commitments*

The following table summarizes our contractual obligations and commercial commitments at December 31, 2006, and the effect such obligations could have on our liquidity and cash flow in future periods (in thousands):

	Payments Due by Fiscal Year					Total
	2007	2008	2009	2010	2011	
Operating leases	\$ 1,895	\$ 1,483	\$ 1,516	\$ 1,589	\$ 88	\$ 6,571
Committed purchase orders	113,686	—	—	—	—	113,686
Total contractual obligations	\$ 115,581	\$ 1,483	\$ 1,516	\$ 1,589	\$ 88	\$ 120,257

#### *Other Liquidity Needs*

During the next twelve months we plan to incur approximately \$15.0 million to \$18.0 million for capital expenditures and the acquisition of additional licenses. In addition, certain of our operating leases related to facilities obligate us to pay an aggregate of approximately \$500,000, net of sublease income, over the next 9 months. This obligation is included in the operating lease commitments in the above table.

We believe that our available cash and investments together with our operating cash flows and available borrowings under our line of credit facility, will be sufficient to fund operations, including the continued expansion of our sales and marketing team, the further development of our new products and the related increase in our general and administrative expenses, and to satisfy our working capital requirements and anticipated capital expenditures for the next twelve months. We expect that a significant source of funds in the future will be our operating cash flow. Our future revenue is dependent on us fulfilling our commitments under agreements with a small number of major customers. Our liquidity could be impaired if there is any interruption in our business operations, a material failure to satisfy these contractual commitments or a failure to generate additional revenue from new or existing products.

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

Our investment portfolio is maintained in accordance with our investment policy that defines allowable investments, specifies credit quality standards and limits our credit exposure to any single issuer. The fair value of our cash equivalents and marketable securities is subject to change as a result of changes in market interest rates and investment risk related to the issuers' credit worthiness. We do not utilize financial contracts to manage our exposure in our investment portfolio to changes in interest rates. At December 31, 2006, we had \$84.2 million in cash, cash equivalents and marketable securities, all of which are stated at fair value. Changes in market interest rates would not be expected to have a material impact on the fair value of \$34.6 million of our cash and cash equivalents at December 31, 2006, as these consisted of securities with maturities of less than three months. A 100 basis point increase or decrease in interest rates would, however, decrease or increase, respectively, the remaining \$49.6 million of our investments by approximately \$500,000. While changes in interest rates may affect the fair value of our investment portfolio, any gains or losses will not be recognized in our Consolidated Statements of Operations until the investment is sold or if the reduction in fair value was determined to be other than temporary.

**Foreign Currency Exchange Rate Risk**

During 2006, approximately \$54.7 million of our sales transactions were denominated in Euros. In order to hedge against the short-term impact of foreign currency fluctuations on our accounts receivable balances we have entered into forward foreign exchange contracts. The effect of exchange rate changes on forward foreign exchange contracts is expected to offset the effect of exchange rate changes on the underlying hedged items. We believe these financial instruments do not subject us to speculative risk that would otherwise result from changes in currency exchange rates. If foreign currency rates were to fluctuate by 10% from rates at December 31, 2006, our financial position, results of operations and cash flows would not be materially affected. We do not use foreign currency forward exchange contracts for speculative or trading purposes.

All of our outstanding foreign currency contracts are marked-to-market, with unrealized gains and losses included as a component of other income and expense. As of December 31, 2006 the total amount of outstanding forward contracts amounted to 12 million Euros. During 2006, we recorded unrealized losses of approximately \$1.4 million on our forward contracts. These unrealized losses were offset by foreign currency gains of approximately \$2.8 million recorded in other income and expense related primarily to our foreign currency receivable balances denominated in Euros during 2006.

Revenues generated outside the United States, as a percentage of total revenues were approximately 37% for the fiscal year ended December 31, 2006 and 58% for 2005. Significant fluctuations in foreign exchange rates could impact future operating results.

**Item 8. Financial Statements and Supplementary Data**

The index to our Consolidated Financial Statements and the Report of Independent Registered Public Accounting Firm appears in Part IV of this Form 10-K.

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

There have been no disagreements with our Independent Registered Public Accounting Firm on accounting and financial disclosures.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures.** We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports to the SEC is recorded,

processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer, or CEO, and chief financial officer, or CFO, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, including internal control over financial reporting, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. For example, a company's operations may change over time, such as the result of new or discontinued lines of business and management must periodically modify a company's internal controls and procedures to timely match these changes in its business. And, in the end, all controls and procedures are necessarily subject to the judgment of management in evaluating the design and cost benefit relationship of possible controls and procedures, and the judgment of company personnel in their application.

As of December 31, 2006, the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our management, including our CEO and CFO, concluded that our disclosure controls and procedures were effective as of December 31, 2006.

**Changes in Internal Control Over Financial Reporting.** An evaluation was also performed under the supervision and with the participation of our management, including our CEO and CFO, of any change in our internal controls over financial reporting that occurred during our last fiscal quarter and that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting. That evaluation did not identify any change in our internal controls over financial reporting that occurred during our latest fiscal quarter and that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

#### **Management's Annual Report on Internal Control over Financial Reporting**

The management of Novatel Wireless, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act rules 13a-15(f) and 15d-15(f). All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control—Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2006.

KPMG LLP, the independent registered public accounting firm that audited the consolidated financial statements of Novatel Wireless included in this Annual Report on Form 10-K, has issued an audit report on management's assessment of the effectiveness of Novatel Wireless' internal control over financial reporting as of December 31, 2006. The report, which expresses unqualified opinions on management's assessment and on the effectiveness of Novatel Wireless' internal control over financial reporting as of December 31, 2006, is included in this Item under the heading "Report of Independent Registered Public Accounting Firm."

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Novatel Wireless, Inc. and subsidiaries

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting as of December 31, 2006, that Novatel Wireless, Inc. and subsidiaries (Novatel Wireless) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Novatel Wireless' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's 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 in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Novatel Wireless maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Novatel Wireless maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Novatel Wireless, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated March 16, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

San Diego, California  
March 16, 2007

**Item 9B. Other Information**

The financial statements included in this report contain updated information from that which the Company furnished on February 27, 2007, including a \$200,000 increase in benefit for income taxes and net income. The updated information does not impact the previously reported earnings per share of \$0.01 for the year ended December 31, 2006, however the previously reported earnings per share for the three months ended December 31, 2006 increased from \$0.08 to \$0.09. The update resulted from the tax effects of share-based compensation upon completion of our 2006 tax provision.

## PART III

### **Item 10. Directors, Executive Officers and Corporate Governance**

(a) *Identification of Directors.* The information under the caption “Election of Directors,” appearing in the Proxy Statement to be filed for the 2007 Annual Meeting of Stockholders is incorporated herein by reference.

(b) *Identification of Executive Officers.* The information under the caption “Certain Information with Respect to Executive Officers,” appearing in the Proxy Statement to be filed for the 2007 Annual Meeting of Stockholders is incorporated herein by reference.

(c) *Compliance with Section 16(a) of the Exchange Act.* The information under the caption “Compliance with Section 16(a) of the Exchange Act,” appearing in the Proxy Statement to be filed for the 2007 Annual Meeting of Stockholders is incorporated herein by reference.

(d) *Code of Ethics.* The Company has adopted a *Code of Business Conduct and Ethics* which, together with the policies referred to therein, is applicable to all directors, officers and employees of the Company. The Code of Business Conduct and Ethics covers all areas of professional conduct, including conflicts of interest, disclosure obligations, insider trading and confidential information, as well as compliance with all laws, rules and regulations applicable to our business. The Company encourages all employees, officers and directors to promptly report any violations of any of the Company’s policies. In the event that a substantive amendment to, or a waiver from, a provision of the Code of Business Conduct and Ethics that applies to our principal executive officer or principal financial and accounting officer is necessary, the company intends to post such information on its website. A copy of our Code of Business Conduct and Ethics can be obtained from our website at [www.novatelwireless.com](http://www.novatelwireless.com).

(e) *Audit Committee.* The information under the caption “Information Regarding the Board and its Standing Committees,” appearing in the Proxy Statement to be filed for the 2007 Annual Meeting of Stockholders is incorporated herein by reference.

### **Item 11. Executive Compensation**

The information under the heading “Executive Compensation and Other Information” appearing in the Proxy Statement to be filed for the 2007 Annual Meeting of Stockholders is incorporated herein by reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information under the heading “Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters” appearing in the Proxy Statement to be filed for the 2007 Annual Meeting of Stockholders is incorporated herein by reference.

### **Item 13. Certain Relationships and Related Transactions, and Director Independence**

The information under the heading “Certain Relationships and Related Transactions and Director Independence,” appearing in the Proxy Statement to be filed for the 2007 Annual Meeting of Stockholders is incorporated herein by reference.

### **Item 14. Principal Accountant Fees and Services**

The information under the heading “Principal Accountant Fees and Services,” appearing in the Proxy Statement to be filed for the 2007 Annual Meeting of Stockholders is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

**(a) 1. Index to Consolidated Financial Statements**

See Index to Consolidated Financial Statements and financial statement schedules.

**(a) 2. Index to Financial Statement Schedules**

The following Financial Statement Schedules for the years ended December 31, 2006, 2005 and 2004 should be read in conjunction with the Consolidated Financial Statements, and related notes thereto.

<u>Schedule</u>	<u>Page</u>
Schedule II—Valuation and Qualifying Accounts	F-31

Schedules not listed above have been omitted because they are not applicable or are not required or the information required to be set forth therein is included in the Consolidated Financial Statements or notes thereto.

**(b) Exhibits**

The following Exhibits are filed as part of, or incorporated by reference into, this Report on Form 10-K:

<u>Exhibit Number</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 27, 2001).
3.2	Certificate of Amendment to Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2002, filed on November 14, 2002).
3.3	Certificate of Amendment to Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.2 to the Company's Amendment No. 1 to Form 10-K on Form 10-K/A for the year ended December 31, 2003, filed March 31, 2004).
3.4	Amended and Restated Certificate of Designation of Series A Convertible Preferred Stock (incorporated by reference to Exhibit 3.4 to the Company's Amendment No. 1 to Form 10-K on Form 10-K/A for the year ended December 31, 2003, filed March 31, 2004).
3.5	Certificate of Designation of Series B Convertible Preferred Stock (incorporated by reference to Exhibit 3.5 to the Company's Amendment No. 1 to Form 10-K on Form 10-K/A for the year ended December 31, 2003, filed March 31, 2004).
3.6	Bylaws (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 27, 2001).
4.1	Amended and Restated Registration Rights Agreement, dated as of June 15, 1999, by and among the Company and certain of its stockholders (incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
4.2	Amended and Restated Investors' Rights Agreement, dated as of June 30, 2000, by and among the Company and certain of its stockholders (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
4.3	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).

<u>Exhibit Number</u>	<u>Description</u>
4.4	Form of Preferred Stock and Warrant Purchase Agreement entered into in connection with the Company's 2001 Series A Convertible Preferred Stock Financing (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed January 18, 2002).
4.5	Registration Rights Agreement dated as of September 12, 2002 by and among the Company and certain of its stockholders (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed October 21, 2002).
4.6	Form of Securities Purchase Agreement entered into in connection with the Company's 2003 Series B Convertible Preferred Stock Financing (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed March 28, 2003).
4.7	Registration Rights Agreement entered into in connection with the Company's 2003 Series B Convertible Preferred Stock Financing (incorporated by reference to Exhibit 4.8 to the Company's Current Report on Form 8-K, filed March 28, 2003).
4.8	Securities Purchase Agreement entered into in connection with the Company's January 2004 Common Stock and Warrant Financing Transaction (incorporated by reference to Exhibit 10.20 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003, filed March 15, 2004).
4.9	Registration Rights Agreement entered into in connection with the Company's January 2004 Common Stock and Warrant Financing Transaction (incorporated by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003, filed March 15, 2004).
4.10	Form of Common Stock Purchase Warrant issued in connection with the Company's January 2004 Common Stock and Warrant Financing Transaction (incorporated by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003, filed March 15, 2004).
10.1	Amended and Restated 1997 Employee Stock Option Plan ("1997 Plan") (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
10.2	Amended and Restated Novatel Wireless, Inc. 2000 Stock Incentive Plan ("2000 Plan") (incorporated by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.3	Form of Executive Officer Stock Option Agreement under the 2000 Plan (incorporated by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.4	Form of Director Stock Option Agreement under the 2000 Plan (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.5	Form of Amendment of Stock Option Agreements dated July 20, 2006 by and between the Company and Optionee with respect to the 1997 Plan (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed November 9, 2006).
10.6	Form of Amendment of Stock Option Agreements dated July 20, 2006 by and between the Company and Optionee with respect to the 2000 Plan (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed November 9, 2006).
10.7	Form of Amendment of Stock Option Agreements dated July 20, 2006 by and between the Company and Optionee with respect to the 2000 Plan and grants made pursuant thereto in 2004 and subsequently (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed November 9, 2006).

<u>Exhibit Number</u>	<u>Description</u>
10.8	Amended and Restated Novatel Wireless, Inc. 2000 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.9	Form of Restricted Share Award agreement for restricted stock granted to non-employee Directors (incorporated by reference to Exhibit 10.10 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2006, filed August 9, 2006).
10.10	Form of Restricted Share Award agreement for restricted stock granted to executive officers (incorporated by reference to Exhibit 10.11 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2006, filed August 9, 2006).
10.11	Form of 2006 Management Bonus Plan (incorporated by reference to Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2006, filed August 9, 2006).
10.12	Form of Indemnification Agreement by and between the Company and each of its executive officers and directors (incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
10.13	Form of Change of Control Letter Agreement by and between the Company and certain of its executive officers (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed August 16, 2004).
10.14	Form of Executive Officer Bonus Plan (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2005, filed May 10, 2005).
10.15	Credit Agreement, dated December 29, 2005, by and between Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.16	Executive Chairman Agreement, dated October 19, 2006, by and between Peter V. Leparulo and the Company (incorporated by reference to Exhibit 99.3 to the Company's Current Report on Form 8-K, filed October 24, 2006).
21	Subsidiaries of Novatel Wireless, Inc. (incorporated by reference to Exhibit 21 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
23.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm.*
24	Power of Attorney (See signature page).
31.1	Certification of our Chief Executive Officer adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of our Chief Financial Officer adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

\* Filed electronically herewith

#### **Supplemental Information**

No Annual Report to Stockholders or annual Proxy materials have been sent to our stockholders as of the date of this report. The Annual Report to Stockholders and annual Proxy materials will be furnished to our stockholders subsequent to the filing of this report and we will provide such material to the SEC at that time.



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**NOVATEL WIRELESS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except per share data)

	As of December 31,	
	2006	2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 34,612	\$ 36,653
Marketable securities	48,071	47,075
Accounts receivable, net of allowance for doubtful accounts of \$631 in 2006 and \$96 in 2005	47,774	28,121
Inventories	25,662	23,132
Deferred tax assets, net	5,931	5,253
Prepaid expenses and other	3,344	9,821
Total current assets	<u>165,394</u>	<u>150,055</u>
Property and equipment, net	15,501	13,865
Marketable securities	1,479	6,611
Intangible assets, net	2,411	3,459
Deferred tax assets, net	6,630	1,849
Other assets	230	225
	<u>\$ 191,645</u>	<u>\$ 176,064</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 39,346	\$ 34,226
Accrued expenses	18,063	11,888
Line of credit	—	5,000
Capital lease obligations	—	3,891
Total current liabilities	<u>57,409</u>	<u>55,005</u>
Commitments and contingencies		
Stockholders' equity:		
Series A and B Preferred stock, par value \$0.001, 2,000 shares authorized and none outstanding	—	—
Common stock, par value \$0.001, 50,000 shares authorized, 29,743 and 29,326 shares issued and outstanding at December 31, 2006 and 2005, respectively	30	29
Additional paid-in capital	356,138	343,738
Accumulated other comprehensive loss	(31)	(364)
Accumulated deficit	(221,901)	(222,344)
Total stockholders' equity	<u>134,236</u>	<u>121,059</u>
	<u>\$ 191,645</u>	<u>\$ 176,064</u>

See accompanying notes to consolidated financial statements

**NOVATEL WIRELESS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)

	Year Ended December 31,		
	2006	2005	2004
Revenue	\$ 217,972	\$ 161,736	\$ 103,727
Cost of revenue	162,749	115,568	69,780
Gross margin	<u>55,223</u>	<u>46,168</u>	<u>33,947</u>
Operating costs and expenses:			
Research and development	31,317	20,515	10,625
Sales and marketing	14,168	7,611	4,739
General and administrative	16,306	7,528	5,138
Total operating costs and expenses	<u>61,791</u>	<u>35,654</u>	<u>20,502</u>
Operating income (loss)	(6,568)	10,514	13,445
Other income (expense):			
Interest income	3,032	2,251	927
Interest expense	(134)	(27)	(56)
Other income (expense), net	1,407	(216)	(148)
Income (loss) before income taxes	<u>(2,263)</u>	<u>12,522</u>	<u>14,168</u>
Provision (benefit) for income taxes	<u>(2,706)</u>	<u>1,406</u>	<u>349</u>
Net income after income taxes	443	11,116	13,819
Accretion of dividends and beneficial conversion features pertaining to preferred stock	—	—	(145)
Net income applicable to common stockholders	<u>\$ 443</u>	<u>\$ 11,116</u>	<u>\$ 13,674</u>
Per share data:			
Net income per common share:			
Basic	\$ 0.01	\$ 0.38	\$ 0.57
Diluted	\$ 0.01	\$ 0.37	\$ 0.48
Weighted average shares used in computation of basic and diluted net income) per common share:			
Basic	29,580	29,132	23,969
Diluted	30,058	30,319	28,863

See accompanying notes to consolidated financial statements

NOVATEL WIRELESS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME  
(in thousands)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Deferred Compensation	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity	Total Comprehensive Income
	Shares	Amount	Shares	Amount						
Balance, December 31, 2003	6	\$ —	12,738	\$ 13	\$256,253	\$ (142)	\$ (247,134)	\$ —	\$ 8,990	\$ —
Exercise of stock options and warrants	—	—	3,646	4	8,578	—	—	—	8,582	—
Tax benefit from exercise of stock options	—	—	—	—	349	—	—	—	349	—
Amortization of deferred compensation	—	—	—	—	—	142	—	—	142	—
Shares issued under employee stock purchase plan	—	—	6	—	89	—	—	—	89	—
Accretion of dividends on Series A preferred stock	—	—	—	—	18	—	(18)	—	—	—
Conversion of Series A preferred stock into shares of common stock	(1)	—	102	—	—	—	—	—	—	—
Conversion of Series B preferred stock into shares of common stock	(5)	—	7,059	7	(7)	—	—	—	—	—
Accretion of dividends on Series B preferred stock	—	—	—	—	127	—	(127)	—	—	—
Issuance of common stock, net of offering costs	—	—	5,393	5	68,538	—	—	—	68,543	—
Net income	—	—	—	—	—	—	13,819	—	13,819	13,819
Other comprehensive loss:										
Unrealized loss on marketable securities	—	—	—	—	—	—	—	(336)	(336)	(336)
Total comprehensive income										\$ 13,483
Balance, December 31, 2004	—	—	28,944	29	333,945	—	(233,460)	(336)	100,178	
Exercise of stock options and warrants	—	—	327	—	1,031	—	—	—	1,031	\$ —
Shares issued under employee stock purchase plan	—	—	55	—	546	—	—	—	546	—
Tax benefit from reversal of deferred tax asset valuation	—	—	—	—	8,216	—	—	—	8,216	—
Net income	—	—	—	—	—	—	11,116	—	11,116	11,116
Other comprehensive loss:										
Unrealized loss on marketable securities	—	—	—	—	—	—	—	(28)	(28)	(28)
Total comprehensive income										\$ 11,088
Balance, December 31, 2005	—	—	29,326	29	343,738	—	(222,344)	(364)	121,059	
Exercise of stock options and warrants	—	—	338	1	990	—	—	—	991	\$ —
Shares issued under employee stock purchase plan	—	—	79	—	683	—	—	—	683	—
Share-based compensation	—	—	—	—	10,011	—	—	—	10,011	—
Net income	—	—	—	—	—	—	443	—	443	443
Other comprehensive loss:										
Tax benefits from stock options exercised	—	—	—	—	716	—	—	—	716	716
Unrealized gain on marketable securities	—	—	—	—	—	—	—	333	333	333
Total comprehensive income										\$ 1,492
Balance, December 31, 2006	—	\$ —	29,743	\$ 30	\$356,138	\$ —	\$ (221,901)	\$ (31)	\$ 134,236	

See accompanying notes to consolidated financial statements

**NOVATEL WIRELESS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Year Ended December 31,		
	2006	2005	2004
<b>Cash flows from operating activities:</b>			
Net income	\$ 443	\$ 11,116	\$ 13,819
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	8,037	4,472	3,655
Provision for bad debt	635	19	—
Inventory write-offs	2,924	2,937	131
Share-based compensation expense	10,011	—	—
Tax benefit from stock options exercised	(716)	—	—
Loss on sale of property and equipment	—	—	80
Amortization of deferred compensation for stock options issued below fair value	—	—	142
Non-cash income tax expense (benefit)	(4,743)	1,114	349
Changes in assets and liabilities:			
Restricted cash	—	—	635
Accounts receivable, net	(20,288)	(14,079)	(4,676)
Inventories	(5,454)	(16,415)	(7,435)
Prepaid expenses and other assets	6,472	(7,754)	(726)
Accounts payable	5,120	28,274	(778)
Accrued expenses	6,332	3,593	6,783
Restructuring accrual	(205)	(240)	(649)
Deferred revenues	48	(531)	(5,687)
Net cash provided by operating activities	<u>8,616</u>	<u>12,506</u>	<u>5,643</u>
<b>Cash flows from investing activities:</b>			
Purchases of property and equipment	(8,125)	(6,752)	(2,378)
Proceeds from sale of property and equipment	—	—	31
Purchases of licensed technologies	(500)	(390)	(1,820)
Purchases of securities	(60,758)	(43,664)	(75,789)
Securities maturities/sales	65,227	54,684	10,718
Net cash provided by (used in) investing activities	<u>(4,156)</u>	<u>3,878</u>	<u>(69,238)</u>
<b>Cash flows from financing activities:</b>			
Proceeds from (payments on) line of credit	(5,000)	5,000	—
Payments under capital lease obligations	(3,891)	(2,794)	(1,075)
Proceeds from exercise of stock options and warrants	991	1,031	8,582
Proceeds from shares issued under the employee stock purchase plan	683	546	89
Excess tax benefits from stock options exercised	716	—	—
Net proceeds from the issuance of common stock	—	—	68,543
Net cash provided by (used in) financing activities	<u>(6,501)</u>	<u>3,783</u>	<u>76,139</u>
Net increase (decrease) in cash and cash equivalents	<u>(2,041)</u>	<u>20,167</u>	<u>12,544</u>
Cash and cash equivalents, beginning of year	36,653	16,486	3,942
Cash and cash equivalents, end of year	<u>\$ 34,612</u>	<u>\$ 36,653</u>	<u>\$ 16,486</u>

**NOVATEL WIRELESS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS—(Continued)**  
(in thousands)

	Year Ended December 31,		
	2006	2005	2004
<b>Supplemental disclosures of non-cash investing and financing activities:</b>			
Accretion of dividends on Series A convertible preferred stock	\$ —	\$ —	\$ 18
Conversion of Series B preferred stock into shares of common stock	\$ —	\$ —	\$ 7
Accretion of dividends on Series B preferred stock	\$ —	\$ —	\$ 127
Capital lease obligations	\$ —	\$ 5,558	\$ 2,120
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for interest	\$ 134	\$ 27	\$ 56
Cash paid during the year for taxes	\$ 383	\$ —	\$ —

See accompanying notes to consolidated financial statements

**NOVATEL WIRELESS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Nature of Business and Significant Accounting Policies**

Novatel Wireless, Inc. (the "Company") was incorporated in 1996 under the laws of the State of Delaware. The Company is a provider of wireless broadband access solutions for the worldwide mobile communications market. The Company's broad range of products includes 3G wireless PC card and ExpressCard modems, embedded modems, communications software and Fixed-Mobile Convergence (FMC) solutions for wireless network operators, infrastructure providers, distributors, original equipment manufacturers (OEMs), and vertical markets worldwide. Through the integration of its hardware and software, the Company's products are designed to operate on a majority of global wireless networks and provide mobile subscribers with secure and convenient high speed access to corporate, public and personal information through the Internet and enterprise networks. The Company also offers software engineering, integration and design services to its customers to facilitate the use of its products.

*Principles of Consolidation*

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

*Use of 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. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues, expenses and disclosures of contingent assets and liabilities. Actual results could differ materially from these estimates.

*Cash and Cash Equivalents*

Cash and cash equivalents include highly liquid investments with original maturities of three months or less at the time of acquisition. Cash and cash equivalents consist of money market and mutual funds, U.S. government and other corporate debt securities and are recorded at market value, which approximates cost. Cash and cash equivalents balances were \$34.6 million at December 31, 2006 and \$36.7 million at December 31, 2005.

*Marketable Securities*

The Company accounts for its marketable securities in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. All of the Company's cash equivalents and marketable securities are treated as "available-for-sale" under SFAS No. 115. Marketable securities consist of highly liquid investments with a maturity of greater than three months when purchased. While it is the Company's intent to hold such securities until maturity, the Company may sell certain securities for cash flow purposes. Thus, the Company's marketable securities are classified as available-for-sale and are carried on the balance sheet at fair value with the related unrealized gains and losses included in accumulated other comprehensive income, a component of stockholders' equity. Realized gains and losses on the sale of marketable securities are determined using the specific-identification method.

*Inventories*

Inventories are stated at the lower of cost (first-in, first-out method) or market. Cash flows from the sale of inventories are included in cash flows from operating activities in the consolidated statements of cash flows.

**NOVATEL WIRELESS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Property and Equipment*

Property and equipment are stated at cost and depreciated using the straight-line method. Test equipment, computer equipment and purchased software, furniture and fixtures and product tooling are depreciated over lives ranging from two to five years and leasehold improvements are depreciated over the shorter of the related lease period or useful life. Amortization of assets held under capital leases is included in depreciation expense.

Expenditures for repairs and maintenance are expensed as incurred. Expenditures for major renewals and betterments that extend the useful lives of existing property and equipment are capitalized and depreciated. Upon retirement or disposition of property and equipment, any resulting gain or loss is recognized in the consolidated statements of operations.

*Intangible Assets*

Intangible assets include the costs of non-exclusive and perpetual worldwide software technology licenses and software development costs. License costs are amortized on a straight-line basis over the estimated useful lives of the assets, which is estimated at five years.

*Long-Lived Assets*

The Company periodically evaluates the carrying value of the unamortized balances of its long-lived assets, including fixed and intangible assets, to determine whether impairment of these assets has occurred or whether a revision to the related amortization periods should be made. This evaluation is based on management's projections of the discounted future cash flows associated with each class of asset. If management's evaluation indicates that the carrying values of these assets are impaired, such impairment is recognized by a reduction of the applicable asset carrying value to its estimated fair value and expensed through operations.

*Revenue Recognition*

The Company's revenue is generated from the sale of wireless modems to wireless operators, OEM customers, value added resellers (VARs) and distributors and from development services contracts. Revenue from product sales is recognized upon the latest of transfer of title or shipment of the product to the customer. For product sales with acceptance provisions, revenue is recognized at such time that the acceptance provisions are satisfied. The Company records deferred revenue for cash payments received from customers in advance of when revenue recognition criteria are met. The Company grants price protection to certain customers in accordance with the provisions of the respective contracts and tracks pricing and other terms offered to customers buying similar products to assess compliance with these provisions. To date, the Company has not incurred material price protection expenses. Revenues from sales to certain customers are subject to cooperative advertising. Allowances for cooperative advertising are provided for upon revenue recognition. Such amounts are recorded as a reduction of revenue or operating expense in accordance with EITF No. 01-9. The Company establishes reserves for estimated product returns allowances in the period in which revenue is recognized. In estimating future product returns, the Company considers various relevant factors, including the Company's stated return policies and practices and historical trends. The Company recognizes revenue in accordance with Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," as amended by SAB No. 104, which provides guidance on the application of generally accepted accounting principles to selected revenue recognition issues.

For its fixed price development services contracts, the Company recognizes revenue as services are rendered using labor output measures or the achievement of milestones as indicators of progress. Total estimated costs are

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

based on management's assessment of costs to complete the project including periodic assessments of the progress achieved and the costs expended to date. To the extent that estimated costs materially change, revenue and profit recorded under the associated contract is adjusted accordingly. If total costs of completion are estimated to exceed the contract value, a loss is recognized in the period the loss is identified. Total revenue recognized for development services during 2006, 2005, and 2004 amounted to zero, \$500,000, and \$4.0 million, respectively. Total costs of revenue incurred for development services in 2006, 2005, and 2004 amounted to zero, \$200,000 and \$2.9 million, respectively. The Company expects that, going forward, the level of engineering services revenue, as a percentage of total revenue, will not be significant.

During 2003, the Company entered into a joint development agreement containing multiple elements with one of its customers. These elements include development services and product shipments. Accordingly, the Company has separated its deliverables into units of accounting and recognized revenue on these deliverables, consistent with the provisions of Emerging Issues Task Force ("EITF") Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." Accordingly, \$6.2 million in cash payments received in 2003 were recorded as deferred revenue, of which approximately \$5.7 million had been recognized as revenue as products were shipped or as services were rendered during 2004. The remaining \$531,000 was recognized as revenue as products were shipped during 2005.

*Research and Development Costs*

Research and development costs are expensed as incurred. Revenue is recorded for research and development efforts that are reimbursed under development services contracts with the related costs classified as cost of revenues.

*Warranty Costs*

The Company accrues warranty costs based on estimates of future warranty related replacement, repairs or rework of products. The Company's warranty policy generally provides one to three years of coverage for products following the date of purchase. The Company's policy is to accrue the estimated cost of warranty coverage as a component of cost of revenue in the accompanying consolidated statements of operations at the time revenue is recognized. In estimating its future warranty obligations the Company considers various relevant factors, including the historical frequency and volume of claims, and the cost to replace or repair products under warranty. The warranty provision for its products is determined by using a financial model to estimate future warranty costs. The Company's financial model takes into consideration actual product failure rates; estimated replacement, repair or rework expenses; and potential risks associated with its different products. The risk levels, warranty cost information, and failure rates used within its model are reviewed throughout the year and updated, if and when, these inputs change. The Company has not experienced significant variances in the past between its estimated and actual warranty costs. Depending on the quality of the Company's product design and manufacturing, actual product failure rates or actual warranty costs could be materially different than its estimates, which could harm its financial condition and results of operations.

*Royalty Costs*

The Company has license agreements which commit it to royalty payments generally based on a percentage of the sales price of its products using certain technologies. The Company recognizes royalty obligations in accordance with terms of the respective royalty agreements. The Company has also accrued for royalty costs in cases where it does not have agreements by using its current best estimate of its obligation. These estimates are based on various market data information and other relevant information. If the Company enters into such agreements, or when additional market data becomes available, it revises its estimates accordingly.

**NOVATEL WIRELESS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Income Taxes*

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires the use of the asset and liability method of accounting for deferred income taxes. Under this method, deferred income taxes are recorded to reflect the tax consequences on future years of temporary differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is recognized.

*Derivatives and Hedging*

The Company enters into derivative financial instrument contracts only for hedging purposes and accounts for them in accordance with SFAS No. 133 and its amendments SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133," SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities" and SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." These derivative financial instruments consist solely of foreign currency forward exchange contracts. The purpose of these derivative instruments is to hedge the Company's economic exposure associated with sales and asset balances denominated in Euros. The Company's forward contracts do not qualify as accounting hedges as prescribed by SFAS No. 133. The Company marks-to-market the forward contracts and includes unrealized gains and losses in the current period as a component of other income (expense) in the consolidated statements of operations.

As of December 31, 2006 the total amount of outstanding forward contracts amounted to 12 million Euros. For the years ended December 31, 2006 and 2005, the Company recorded a loss of \$1.4 million and a gain of \$1.8 million on its foreign currency forward exchange contracts, respectively.

*Litigation*

The Company is currently involved in certain legal proceedings. The Company estimates the range of liability related to pending litigation where the amount and range of loss can be estimated. The Company records its best estimate of a loss when the loss is considered probable. Where a liability is probable and there is a range of estimated loss with no best estimate in the range, the Company records the minimum estimated liability related to the claim. As additional information becomes available, the Company assesses the potential liability related to the Company's pending litigation and revises its estimates, if necessary.

*Share-Based Compensation Information under SFAS 123R*

The Company has granted incentive stock options to employees, and restricted stock and non-qualified stock options to employees and non-employee members of the Board of Directors. The Company also has an employee stock purchase plan for all eligible employees. On January 1, 2006, the Company adopted SFAS No. 123(R), Share-Based Payment, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including stock option grants, non-vested stock grants, and purchases of stock made pursuant to the Company's ESPP based on estimated fair values. SFAS No. 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion ("APB") No. 25, Accounting for Stock Issued to Employees. In March 2005, the SEC issued Staff Accounting Bulletin ("SAB") No. 107, and the Company has applied the provisions of SAB No. 107 in its adoption of SFAS No. 123(R).

The Company adopted SFAS No. 123(R) using the modified prospective transition method of recognition of compensation expense related to share-based payments, which requires the application of the accounting standard

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

as of January 1, 2006. In accordance with the modified prospective transition method, the Company's consolidated financial statements for the year ended December 31, 2005 have not been restated to reflect, and do not include, the impact of SFAS No. 123(R).

SFAS No. 123(R) requires companies to estimate the fair value of share-based payment option awards on the date of grant using an option-pricing model. The value of the awards that are ultimately expected to vest are recognized as compensation expense over the requisite service periods using the straight-line method. Prior to the adoption of SFAS No. 123(R), the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with APB No. 25 as allowed under SFAS No. 123, Accounting for Stock-Based Compensation. Under the intrinsic value method, share-based compensation expense was only recognized by the Company if the exercise price of the grant was less than the fair market value of the underlying stock at the date of grant. No stock-based compensation expense was recorded by the Company in 2005.

As of December 31, 2006, total unrecognized share-based compensation cost related to unvested stock options was \$10.2 million, which is expected to be recognized over a weighted average period of approximately 14 months. As of December 31, 2006, total unrecognized share-based compensation cost related to restricted stock was \$1.4 million, which is expected to be recognized over a weighted average period of approximately 19 months. As of December 31, 2006, total unrecognized ESPP compensation cost related to ESPP share purchases was approximately \$300,000, which is expected to be recognized over a weighted average period of approximately six months. The Company has included the following amounts for share-based compensation expense, including the cost related to the ESPP, in the consolidated statements of operations for the year ended December 31, 2006 (in thousands, except per share data):

	<u>Year Ended</u> <u>December 31, 2006</u>
Cost of revenue	\$ 487
Research and development	2,269
Sales and marketing	1,997
General and administrative	5,258
Total	<u>10,011</u>
Tax effect on share-based compensation	(2,607)
Net effect on net income	<u>\$ 7,404</u>
Effect on earnings per share:	
Basic	\$ 0.25
Diluted	\$ 0.25

Share-based compensation expense recognized during the year ended December 31, 2006 included (1) compensation expense for awards granted prior to, but not yet fully vested as of January 1, 2006, and (2) compensation expense for the share-based payment awards granted subsequent to December 31, 2005, based on the grant date fair values estimated in accordance with the provisions of SFAS No. 123 and SFAS No. 123(R), respectively. The Company has historically disclosed and currently recognizes share-based compensation expense using the straight-line method. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma disclosures required under SFAS No. 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred. The Company has historically and continues to estimate the fair value of share based option awards using the Black-Scholes option-pricing model.

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Pro-Forma Information under SFAS No. 123 for periods Prior to Fiscal 2006

Prior to January 1, 2006, the Company disclosed compensation cost in accordance with SFAS No. 123. The provisions of SFAS No. 123 required the Company to disclose the assumptions used in calculating the fair value pro forma expense. Had compensation expense for the plans been determined based on the fair value of the options at the grant dates for awards under the plans consistent with SFAS No. 123, the Company's net income (loss) for years ended December 31, 2005 and 2004 would have been as follows (in thousands, except per share data):

	2005	2004
Net income applicable to common stockholders, as reported	\$ 11,116	\$13,674
Add: Share-based employee compensation expense included in reported net income available to common stockholders, net of related tax benefits	—	142
Deduct: Share-based employee compensation expense determined under the fair value based method for all awards, net of related tax benefits	(18,815)	(8,624)
Net income (loss) applicable to common stockholders, pro forma	<u>\$ (7,699)</u>	<u>\$ 5,192</u>
Net income per share, Basic as reported	\$ 0.38	\$ 0.57
Net income (loss) per share, Basic pro forma	\$ (0.26)	\$ 0.22
Net income per share, Diluted as reported	\$ 0.37	\$ 0.48
Net income (loss) per share, Diluted pro forma	\$ (0.26)	\$ 0.18

Pro forma disclosures for the year ended December 31, 2006 are not presented because the compensation expense is recorded in the consolidated statements of operations.

To estimate compensation expense which would have been recognized under SFAS No. 123 for the years ended December 31, 2005 and 2004, and the compensation cost that was recognized under SFAS No. 123(R) for the year ended December 31, 2006, the Company used the Black-Scholes option-pricing model with the following weighted-average assumptions for equity awards granted:

	Years Ended December 31,		
	2006	2005	2004
Expected dividend yield	0%	0%	0%
Risk-free interest rate:			
Stock Options	4.7%	3.7%	3.1%
ESPP	4.7%	3.7%	3.1%
Volatility:			
Stock Options	71%	66%	90%
ESPP	51%	66%	90%
Expected Term:			
Stock Options	5.5 years	4 years	4 years
ESPP	15 months	15 months	15 months

The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent remaining term. The Company has not paid dividends in the past and currently does not plan to pay any dividends in the foreseeable future. The expected volatility is based on an average of historical and implied volatility of the Company's stock for the related expected life. The expected term of options granted is estimated using the average of the vesting date, the contractual term and historical experience.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*Computation of Net Income Per Share*

SFAS No. 128, "Earnings Per Share," requires companies to compute basic and diluted per share data for all periods for which a statement of operations is presented. Basic net income per share excludes dilution and is computed by dividing the net income applicable to common stockholders by the weighted-average number of common shares that were outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Potential dilutive securities are excluded from the diluted EPS computation in loss periods as their effect would be anti-dilutive.

*Fair Value of Financial Instruments*

The carrying amounts of the Company's cash and cash equivalents, accounts receivable, accounts payable accrued expenses and line of credit approximate their fair value due to their short-term nature. The Company performs credit evaluations of key customers and management believes it is not exposed to significant credit risk on its accounts receivable in excess of established reserves.

*Comprehensive Income*

SFAS No. 130, "Comprehensive Income," requires that all items recognized under accounting standards as components of comprehensive income be reported with the same prominence as other financial statements. Comprehensive income consists of net earnings and unrealized gains and losses on available-for-sale securities.

*Segment Information*

SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information," requires public companies to report financial and descriptive information about their reportable operating segments. The Company identifies its operating segments based on how management internally evaluates separate financial information, business activities and management responsibility. The Company operates in a single business segment consisting of the development, manufacture and sale of wireless access products.

*Recent Accounting Pronouncements*

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Instruments ("SFAS No. 155"). SFAS No. 155 amends SFAS No. 133, Accounting for Derivative Instruments and Hedging and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole, eliminating the need to bifurcate the derivative from its host, if the holder elects to account for the whole instrument on a fair value basis. In addition, among other changes, SFAS No. 155 (i) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; (ii) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; (iii) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and (iv) eliminates the prohibition on a qualifying special-purpose entity ("QSPE") from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial interest. SFAS No. 155 will be applied prospectively and is effective for all financial instruments acquired or issued for fiscal years beginning after September 15, 2006. SFAS No. 155 is not expected to have a material impact on the Company's consolidated financial statements.

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109 (“FIN 48”) and is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainties in income taxes recognized in accordance with SFAS No. 109, “Accounting for Income Taxes” by prescribing guidance for the recognition, derecognition and measurement in financial statements of income tax positions taken in previously filed tax returns or tax positions expected to be taken in tax returns, including a decision whether to file or not to file in a particular jurisdiction. FIN 48 requires that any liability created for unrecognized tax benefits be disclosed. The application of FIN 48 may also affect the tax bases of assets and liabilities and therefore may change or create deferred tax liabilities or assets. The Company will be required to adopt FIN 48 as of January 1, 2007. If there are changes in the net assets of the Company as a result of the application of FIN 48, the cumulative effects, if any, will be recorded as an adjustment to retained earnings. The Company is currently evaluating the impact of its adoption of FIN 48 and has not yet determined the effect on its earnings or financial position.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements”, which is effective for fiscal years beginning after November 15, 2007. SFAS No. 157 defines fair value, establishes a framework for measuring fair value using generally accepted accounting principles, and expands disclosures related to fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for the Company on January 1, 2008. The Company is currently evaluating the impact of its adoption of SFAS No. 157 and has not yet determined the effect on its earnings or financial position.

**2. Marketable Securities**

The Company’s portfolio of available-for-sale securities by contractual maturity consists of the following (in thousands):

December 31, 2006	Maturity in Years	Amortized Cost	Gross Unrealized Losses	Estimated Fair Value
U.S. Agency securities	1 or less	\$ 4,249	\$ (5)	\$ 4,244
Asset backed	1 or less	6,196	(2)	6,194
Certificate of deposits	1 or less	4,293	(2)	4,291
Corporate debenture/bonds	1 or less	33,380	(38)	33,342
Total short-term marketable securities		48,118	(47)	48,071
Corporate debentures/bonds—long-term marketable securities	1 to 2	1,480	(1)	1,479
		\$ 49,598	\$ (48)	\$ 49,550

December 31, 2005	Maturity in Years	Amortized Cost	Gross Unrealized Losses	Estimated Fair Value
U.S. Agency securities	1 or less	\$ 11,781	\$ (118)	\$ 11,663
Corporate bonds	1 or less	27,986	(214)	27,772
Commercial paper	1 or less	7,643	(3)	7,640
Total short-term marketable securities		47,410	(335)	47,075
Corporate bonds—long-term marketable securities	1 to 2	6,640	(29)	6,611
		\$ 54,050	\$ (364)	\$ 53,686

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The unrealized losses for the years ended December 31, 2006 and 2005, of \$48,000, or \$31,000 net of taxes, and \$364,000, respectively, are the result of market conditions affecting fixed-income securities and are included in accumulated other comprehensive loss in the consolidated balance sheets.

At December 31, 2006, the Company did not have any investments in individual securities that have been in a continuous unrealized loss position deemed to be temporary for more than 12 months. Because the Company's general intent is to hold its investment securities to maturity, and considering the high quality of the investment securities, the Company is confident that the unrealized losses at December 31, 2006 represent a temporary condition and will not result in realized losses on sale or maturity of the securities.

### 3. Financial Statement Details

#### *Inventories*

Inventories consist of the following (in thousands):

	December 31,	
	2006	2005
Finished goods	\$ 25,059	\$ 20,325
Raw materials and components	603	2,807
	<u>\$ 25,662</u>	<u>\$ 23,132</u>

#### *Property and Equipment*

Property and equipment consists of the following (in thousands):

	December 31,	
	2006	2005
Test equipment	\$ 20,767	\$ 17,053
Computer equipment and purchased software	9,896	7,960
Product tooling	3,516	2,472
Furniture and fixtures	1,448	1,219
Leasehold improvements	2,010	807
	37,637	29,511
Less—accumulated depreciation and amortization	(22,136)	(15,646)
	<u>\$ 15,501</u>	<u>\$ 13,865</u>

Depreciation and amortization expense was \$6.5 million, \$2.9 million, and \$1.8 million for the years ended December 31, 2006, 2005, and 2004, respectively. At December 31, 2006 and 2005, assets held under capital leases had a net book value of zero and \$6.6 million, respectively, net of accumulated amortization of zero and \$1.1 million, respectively.

**NOVATEL WIRELESS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Intangible Assets*

Intangible assets consist of the following (in thousands):

	December 31,	
	2006	2005
HSDPA, UMTS, and GPRS licenses	\$ 4,735	\$ 4,535
EV-DO and CDMA licenses	4,710	4,410
	<u>9,445</u>	<u>8,945</u>
Less—accumulated amortization	(7,034)	(5,486)
	<u>\$ 2,411</u>	<u>\$ 3,459</u>

Amortization expense relating to intangible licenses was \$1.5 million, \$1.6 million and \$1.8 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Future estimated amortization expense over the following five-year period is as follows (in thousands):

2007	\$ 1,133
2008	568
2009	326
2010	232
2011	142
Thereafter	10
	<u>\$ 2,411</u>

*Accrued Expenses*

Accrued expenses consist of the following (in thousands):

	December 31,	
	2006	2005
Royalties	\$ 6,754	\$ 5,876
Payroll and related	4,947	3,094
Income taxes	1,905	292
Product warranty	1,464	640
Deferred rent	969	352
Professional fees	683	529
Price protection and sales returns allowance	154	186
Restructuring Accrual	128	333
Other	1,059	586
	<u>\$ 18,063</u>	<u>\$ 11,888</u>

**NOVATEL WIRELESS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Restructuring Charges*

The Company reduced its operating costs from 2001 through 2003, primarily through employee layoffs and facility consolidations. No restructuring charges were recorded during 2006, 2005 and 2004. The remaining accrual at December 31, 2006 and 2005 consists solely of lease obligations from exited facilities.

The following table displays the activity and balances of the restructuring accrual from January 1, 2005 to December 31, 2006 (in thousands):

	<u>Facility Closings</u>
Balance—January 1, 2005	\$ 573
Net cash payments	(240)
Balance—December 31, 2005	333
Net cash payments	(205)
Balance—December 31, 2006	<u>\$ 128</u>

Cash payments for facility consolidations of \$128,000 are expected to be paid ratably over the next 9 months.

**4. Income Per Share**

Basic earnings per share (“EPS”) excludes dilution and is computed by dividing net income or loss attributable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

Potentially dilutive securities (currently consisting of options, warrants and restricted stock using the treasury stock method) are excluded from the diluted EPS computation in loss periods and when their exercise price is greater than the market price as their effect would be anti-dilutive. In addition, convertible and redeemable preferred stock were considered in the calculation of diluted earnings per share for 2004. The difference between net income and net loss applicable to common stockholders consists of accretion of dividends on convertible and redeemable preferred stock and amortization of offering costs for convertible and redeemable preferred stock (see Note 5).

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table sets forth the computation of diluted weighted average common and potential common shares outstanding for the years ended December 31, 2006, 2005 and 2004, respectively (in thousands).

	Years Ended December 31,		
	2006	2005	2004
Basic weighted average common shares outstanding	29,580	29,132	23,969
Effect of dilutive securities:			
Warrants	22	74	473
Options	398	1,113	2,030
Restricted Stock	58	—	—
Series A Preferred Stock	—	—	23
Series B Preferred Stock	—	—	2,368
Diluted weighted average common and potential common shares outstanding	<u>30,058</u>	<u>30,319</u>	<u>28,863</u>

Weighted average options and warrants to purchase a total of 4,503,911, 3,151,709, and 899,418 shares of common stock for the years ended December 31, 2006, 2005 and 2004 respectively, were outstanding but not included in the computation of diluted earnings per share as their effect was anti-dilutive.

**5. Stockholders' Equity**

*Financing*

In May 2004, the Company completed an underwritten registered, public equity offering transaction, raising approximately \$61.0 million, net of offering costs and underwriters' commissions of approximately \$4.9 million, upon the issuance of 4,250,000 shares of the Company's common stock. Additionally, in conjunction with this offering, the remaining 4,703 shares of the Company's Series B preferred stock, including accrued dividends, were converted into 7,059,127 shares of common stock, of which 1,750,000 were sold by selling stockholders as part of the equity offering transaction. Net proceeds to the selling shareholders from the sale of these shares amounted to approximately \$25.7 million.

In January 2004, the Company raised proceeds of approximately \$7.5 million, net of fees to the placement agent and offering costs, from the issuance of 1,142,855 shares of common stock in a private placement transaction. Warrants to acquire 228,565 common shares at a price of \$8.83 per share, expiring on January 15, 2009 and exercisable at anytime prior to expiration, were also issued in conjunction with this offering.

*Warrants*

The Company has issued warrants to purchase shares of the Company's capital stock to various investors and lenders as approved by its board of directors.

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

A summary of warrant activity is as follows (in thousands, except per share data):

	December 31,					
	2006		2005		2004	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	208	\$ 7.91	726	\$ 16.84	2,476	\$ 5.94
Granted	—	—	—	—	229	8.83
Expired	—	—	(518)	20.42	—	—
Exercised	(36)	3.60	—	—	(1,979)	2.15
Outstanding, end of year	<u>172</u>	<u>\$ 8.83</u>	<u>208</u>	<u>\$ 7.91</u>	<u>726</u>	<u>\$ 16.84</u>

During 2004, the Company received aggregate proceeds of approximately \$3.7 million in connection with the issuance of 1,944,629 shares of common stock upon the exercise of certain outstanding warrants. Of the warrants exercised during 2004, a total of 39,636 shares of common stock were issued as a result of the cashless exercise of 73,851 warrants at a weighted average exercise price of \$7.97 per share.

In connection with the Private Placement Transaction in January 2004, the Company issued warrants to buy 228,565 shares of common stock. These warrants may be exercised at \$8.83 per share at any time up to January 15, 2009. Under the fair value method, the value of these warrants at the date of issuance was nominal and, accordingly, no value has been assigned to them.

In connection with the Private Placement Transactions in March and May 2003, the Company issued warrants to buy 2,841,072 shares of common stock. These warrants may be exercised at \$0.70 per share at any time up to September 12, 2008 with respect to 857,141 warrants and November 14, 2008 with respect to 1,983,931 warrants. Under the fair value method, the value of these warrants at the date of issuance was determined using the Black-Scholes option-pricing model with the following assumptions: risk free interest rate of 3.5%, volatility of 116% and expected lives of four years. The proceeds from the Private Placement Transactions allocable to the warrants was \$1.4 million which was recorded as a component of Additional Paid-in Capital, and was determined based on the relative fair values of the debt securities issued and warrants granted.

*Common Shares Reserved for Future Issuance*

The Company has reserved shares of common stock for future issuance as of December 31, 2006 as follows (in thousands):

Stock options outstanding	5,460
Stock options available for future grant	1,120
Stock warrants outstanding	172
Shares available under the Employee Stock Purchase Plan	78
Total reserved shares for issuance of common stock	<u>6,830</u>

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*Net Income Applicable to Common Stockholders*

A reconciliation of the net income to net income applicable to common stockholders is as follows (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Net income	\$ 443	\$ 11,116	\$ 13,819
Adjustments to net income used in computing basic and diluted net income applicable to common stockholders:			
Accretion of dividends on Series A preferred stock	—	—	(18)
Accretion of dividends on Series B Preferred Stock	—	—	(127)
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ (145)</u>
Net income available to common stockholders	<u>\$ 443</u>	<u>\$ 11,116</u>	<u>\$ 13,674</u>

**6. Stock Option and Employee Stock Purchase Plans**

*Stock Option Plans*

The Company's amended and restated 1997 employee stock option plan (the "1997 Plan") for employees authorizes the granting of options for up to 800,000 shares of the Company's common stock. Generally, options are to be granted at prices equal to at least 100% of the fair value of the stock on the date of grant, expire not later than ten years from the date of grant and vest ratably and annually over a four-year period following the date of grant. From time to time, as approved by the Company's Board of Directors, options with differing vesting terms have also been granted. The 1997 Plan provides that any shares issued come from the Company's authorized but unissued or reacquired common stock. In September, 2000 the Company suspended making any further grants pursuant to the 1997 Plan and contributed the remaining shares then reserved for issuance under such plan to the 2000 Stock Incentive Plan (the "2000 Plan").

In July 2000, the Company's Board of Directors approved and in September 2000, the Company's stockholders approved the 2000 Plan authorizing the granting of options for up to 1,100,000 shares of the Company's common stock, including the 800,000 shares authorized under the 1997 Plan, plus an automatic annual increase, to be added on the first day of the fiscal year beginning in 2001, equal to the lesser of (a) 3.0% of the outstanding shares on the last day of the prior fiscal year, (b) 100,000 shares, or (c) such lesser number of shares as may be determined by the Board in its sole discretion. The Company implemented the 2000 Plan upon the effective date of the Company's initial public offering in November 2000. The Compensation Committee of the Company's Board of Directors administers the 2000 Plan. Options granted under the 2000 Plan typically vest over either a three or a four year period.

In June 2003, the stockholders of the Company approved the amendment of the 2000 Plan to increase the number of shares reserved for issuance under the plan by 4,222,743 shares of the Company's common stock. In June 2004, the stockholders of the Company approved the amendment of the 2000 Plan to increase the number of shares reserved for issuance under the plan by an additional 2,000,000 shares of the Company's common stock.

In July 2005, the stockholders of the Company approved the amendment of the 2000 Plan to increase the number of shares reserved for issuance under the plan by 1,500,000 shares of the Company's common stock, and eliminate a provision from the plan that provides for the automatic annual increase in the number of shares reserved for issuance effective in 2006. The Company's stockholders also voted to remove a provision from the

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

2000 plan that permitted the repricing of the exercise prices with respect to stock options or stock appreciation rights.

On December 29, 2005, the Company's Board of Directors authorized and approved the acceleration of vesting of certain unvested "out-of-the-money" stock options outstanding under the 2000 Plan that have exercise prices per share of \$18.00 or higher. As a result, options to purchase approximately 550,000 shares of the Company's common stock became fully vested and exercisable immediately. Options held by officers and directors of the Company were not included in the vesting acceleration. The acceleration of the vesting of these stock options eliminates future compensation expense that the Company would otherwise have to recognize in its consolidated statement of operations with respect to such options when SFAS No. 123(R) becomes effective for the Company in the first quarter of 2006. As a result of the acceleration, the Company expects to reduce the stock option expense it otherwise would be required to record by approximately \$6.9 million beginning in 2006 on a pre-tax basis.

A summary of stock option activity is as follows (in thousands, except per share data):

	Options Outstanding	Options Available for Grant	Weighted Average Exercise Price Per Share
Options outstanding January 1, 2004	3,794	1,668	\$ 6.22
New authorized options	—	2,100	—
Granted	2,525	(2,525)	17.03
Exercised	(1,702)	—	2.88
Cancelled	(168)	168	18.58
Options outstanding December 31, 2004	4,449	1,411	\$ 13.17
New authorized options	—	1,600	—
Granted	1,749	(1,749)	12.04
Exercised	(327)	—	3.14
Cancelled	(427)	427	11.08
Options outstanding December 31, 2005	5,444	1,689	\$ 13.58
Granted	798	(798)	10.51
Exercised	(301)	—	2.86
Cancelled	(481)	481	15.95
Restricted stock issuances	—	(252)	10.61
Options outstanding December 31, 2006	5,460	1,120	\$ 13.51
Exercisable, December 31, 2004	892		\$ 18.79
Exercisable, December 31, 2005	3,171		\$ 14.57
Exercisable, December 31, 2006	3,942		\$ 14.10

During the year ended December 31, 2006, the total pre-tax intrinsic value of options exercised to purchase common stock was approximately \$2.3 million, and the weighted average fair value of options to purchase common stock that were granted was \$6.48. During the year ended December 31, 2005, the total pre-tax intrinsic value of options exercised to purchase common stock was \$3.3 million, and the weighted average fair value of options to purchase common stock that were granted was \$6.34 per share. During the year ended December 31, 2004, the total pre-tax intrinsic value of options exercised to purchase common stock was \$27.1 million, and the weighted average fair value of options to purchase common stock that were granted was \$17.03 per share.

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Additional information regarding options outstanding for all plans as of December 31, 2006, is as follows (in thousands, except per share data):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (yrs.)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.95 – 2.65	955	6.41	\$ 2.14	955	\$ 2.14
\$3.90 – 11.04	1,547	8.55	10.30	690	8.86
\$11.26 – 15.43	1,194	8.10	13.36	660	13.62
\$15.77 – 16.27	744	7.33	16.27	684	16.27
\$16.50 – 193.14	1,020	7.09	27.18	953	27.70
Total	5,460		\$ 13.51	3,942	\$ 14.10
Aggregate intrinsic value	\$ 7,752			\$ 7,663	
Weighted average remaining contractual life (in years)		7.62		7.22	

The aggregate intrinsic value in the table above is based on the Company's closing stock price of \$9.67 per share as of the last business day of the year ended December 31, 2006, which amount would have been received by the optionees had all options been exercised on that date.

On May 17, 2006, the Compensation Committee of the Board of Directors, pursuant to the 2000 Plan, granted 222,000 shares of market-based restricted stock to executives at a fair value of \$10.61 per share. The restricted stock awards vest in one-third increments based on closing per share stock price achievement of \$13.26, \$15.92 and \$18.57 for 10 consecutive trading days, but no more than 50% of the shares are permitted to vest earlier than May 1, 2007. If the stock price levels are not achieved, these shares will become fully vested on May 17, 2011 assuming continued employment or other qualifying service for the Company through such date. The Company has estimated the aggregate fair value of this award at approximately \$2.4 million which is being amortized and recorded as compensation expense over a period of eight months for the first \$800,000 of the compensation expense, 17 months for the next \$800,000 of the compensation expense and 28 months for the final \$800,000 of the compensation expense. The vesting term for each increment was calculated using a Monte Carlo valuation model using the following assumptions:

Dividend yield	0%
Volatility	66%
Risk free rate of return	5%

On May 17, 2006, the Company also awarded 7,500 shares of restricted stock to each of the 5 non-employee directors (for a total of 37,500 shares) at a fair value of \$10.61 per share. 2,500 shares of each grant vests annually each May 17, commencing in 2007, so long as the director is serving on such date. The Company has estimated the aggregate fair value of these awards to the non-employee directors at approximately \$400,000, which is being amortized to compensation expense ratably over a three year period.

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Restricted stock activity for the year ended December 31, 2006 is presented below:

	<u>Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Non-vested at May 17, 2006	259,500	\$ 10.61
Granted	—	—
Vested	—	—
Forfeited	(7,500)	—
Non-vested at December 31, 2006	<u>252,000</u>	<u>\$ 10.61</u>

The total fair value of restricted stock recognized as expense during the year ended December 31, 2006 was approximately \$1.3 million and the related tax benefit realized was approximately \$477,000.

*Employee Stock Purchase Plan*

In July 2000, the Company's Board of Directors approved the 2000 Employee Stock Purchase Plan ("ESPP") and in September 2000, the Company's stockholders approved the ESPP. The Company implemented the ESPP in 2001 following the completion of the initial public offering in November 2000. The ESPP, subject to certain limitations, permits eligible employees of the Company to purchase common stock, at a price equal to 85.0% of the lower of the fair market value on the first day of the offering period or the last day of each six-month purchase period, through payroll deductions of up to 10.0% of their annual compensation. The ESPP initially provided for the issuance of up to 100,000 shares of common stock, plus an automatic annual increase, to be added on the first day of the fiscal year beginning in 2001, equal to the lesser of (a) 0.5% of the outstanding shares on the last day of the prior fiscal year, (b) 18,000 shares, or (c) such lesser number of shares as may be determined by the Board in its sole discretion. During 2004, our stockholders approved an amendment to the ESPP which increased the number of shares reserved for future issuance under the ESPP by 80,000 shares. If purchases of stock through the plan deplete this supply, the Company will limit, suspend or discontinue purchases under the plan until additional shares of stock are available. During 2006, the Company sold 78,808 shares under this plan and received \$683,000 in cash. During 2005, the Company sold 54,570 shares under this plan and received \$547,000 in cash.

**7. Income Taxes**

Total income taxes for the years ended December 31, 2006, 2005 and 2004 were allocated as follows (in thousands):

	<u>Year Ended December 31,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
To income from continuing operations	\$(2,706)	\$ 1,406	\$349
To stockholders' equity	(733)	(8,216)	—
Total income taxes	<u>\$(3,439)</u>	<u>\$(6,810)</u>	<u>\$349</u>

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Income (loss) before income taxes for the years ended December 31, 2006, 2005 and 2004 is comprised of the following (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Domestic	\$ (3,490)	\$ 11,695	\$ 13,678
Foreign	1,227	827	490
	<u>\$ (2,263)</u>	<u>\$ 12,522</u>	<u>\$ 14,168</u>

The provision (benefit) for income taxes for the years ended December 31, 2006, 2005 and 2004 is comprised of the following (in thousands):

	Year Ended December 31,		
	2006	2005	2004
<b>Current:</b>			
Federal	\$ 4,546	\$ 4,611	\$ 449
State	42	911	20
Foreign	29	—	—
<b>Total Current</b>	<u>\$ 4,617</u>	<u>\$ 5,522</u>	<u>\$ 469</u>
<b>Deferred:</b>			
Federal	\$ (4,986)	\$ (3,261)	\$ (102)
State	(67)	(855)	(18)
Foreign	(2,270)	—	—
<b>Total Deferred</b>	<u>\$ (7,323)</u>	<u>\$ (4,116)</u>	<u>\$ (120)</u>
Provision (benefit) for income taxes	<u>\$ (2,706)</u>	<u>\$ 1,406</u>	<u>\$ 349</u>

The Company's deferred tax assets and liabilities consist of the following (in thousands):

	December 31	
	2006	2005
<b>Deferred tax assets:</b>		
Accrued expenses	\$ 2,467	\$ 1,185
Inventory obsolescence provision	1,933	1,325
Depreciation and amortization	4,500	4,172
Deferred rent	349	127
Net operating loss and credit carryforwards	3,087	5,500
Stock-based compensation	2,603	—
Deferred tax assets	14,939	12,309
Valuation allowance	(2,378)	(5,207)
<b>Net deferred tax assets</b>	<u>\$ 12,561</u>	<u>\$ 7,102</u>

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The provision (benefit) for income taxes reconciles to the amount computed by applying the statutory federal income tax rate of 34% to income before provision for income taxes as follows (in thousands):

	Year Ended December 31,		
	2006	2005	2004
Federal tax provision, at statutory rate	\$ (769)	\$ 4,383	\$ 4,817
State tax, net of federal benefit	(45)	376	283
Change in valuation allowance	(2,781)	(2,438)	(5,382)
Deferred compensation	—	—	51
Adjustment to State net operating losses and capitalized research and development	—	—	872
Research and development credits	(635)	(853)	(348)
Share-based compensation	997	—	—
Other	527	(62)	56
	<u>\$ (2,706)</u>	<u>\$ 1,406</u>	<u>\$ 349</u>

At December 31, 2006 and 2005, the Company provided a valuation allowance for its deferred tax assets for which significant uncertainty exists regarding the ultimate realization. These assets consist of \$1.5 million relating to certain of the Company net operating loss carryforwards and \$900,000 relating to the Company's Canadian subsidiary. The Company evaluates its deferred tax assets for future realization and reduces it by a valuation allowance to the extent significant uncertainty exists. Many factors are considered when assessing the likelihood of future realization of deferred tax assets including recent cumulative earnings experience, expectations of future taxable income, the carryforwards periods available for tax reporting purposes, and other relevant factors. During 2006, management evaluated the deferred tax valuation allowance and determined that the valuation allowance on a portion of the Canadian deferred tax assets should be revised and as a result, the Company recorded a non-cash deferred income tax benefit to the statements of operations of \$2.4 million for the year ended December 31, 2006. Management believes that it is more likely than not that the results of future operations will generate sufficient future taxable income to realize deferred tax assets, net of the valuation allowance.

At December 31, 2006, the Company has U.S. federal net operating loss carryforwards of approximately \$5.3 million. Federal net operating loss carryforwards expire at various dates from 2011 through 2024. The Company has California net operating loss carryforwards of approximately \$5.3 million, which expire at various dates from 2007 through 2014. The Company also has a California research and development tax credit carryforward of approximately \$1.1 million. The federal tax credits carryforward will expire commencing in 2025 and California tax credits have no expiration date.

During 2005, the Company completed its formal IRC Section 382 study and analysis. The results of this study concluded that the Company experienced several ownership changes for purposes of the IRC Section 382 limitation. As a result of the most recent ownership change, which occurred in 2003, utilization of the Company's net operating loss is subject to an annual limitation under Section 382 determined by multiplying the value of our stock at the time of the ownership change by the applicable long-term tax-exempt rate. The Company estimates its annual limitation for GAAP reporting purposes to be approximately \$311,000. Of the aggregate \$156.5 million net operating carryforward as of December 31, 2005, the Company expects to utilize a total of approximately \$6.2 million for GAAP reporting purposes. Based on the conclusion of the Section 382 study, the Company reduced its deferred tax assets and valuation allowance on these assets by approximately \$52.1 million to reflect this limitation. The Company may take positions for filing our tax returns which differ

**NOVATEL WIRELESS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

from the treatment of the same time or items for financial reporting purposes. Any benefits associated with such tax positions will be reflected in the Company's financial statement when realized.

It is the Company's intention to reinvest undistributed earnings of its foreign subsidiaries and thereby indefinitely postpone their remittance. Accordingly, no provision has been made for foreign withholding taxes on United States income taxes which may become payable if undistributed earnings of the foreign subsidiary were paid as dividends to the Company.

**8. Credit Facility**

On December 29, 2005, the Company entered into a two-year \$25.0 million secured revolving credit facility ("the Credit Agreement"). The Credit Agreement was entered into with Bank of America, N.A., as Administrative Agent, who was granted a first priority blanket lien on substantially all the Company's assets in order to secure repayment of outstanding indebtedness under the Credit Agreement. At the Company's option, borrowings under the Credit Agreement will bear interest at either the London Interbank Offering Rate (LIBOR) plus 100-150 basis points depending on the level of borrowing under the Credit Agreement, or at the prime rate plus 50 basis points (8.75% at December 31, 2006). The Credit Agreement further contains certain customary restrictive financial and operating covenants which, among other things, require the Company to (i) maintain minimum financial performance requirements as measured by the Company's income or loss before taxes, (ii) limit the levels of certain indebtedness and capital expenditures, and (iii) maintain a minimum liquidity ratio. In the event that a default were to occur under the Credit Agreement which was not subsequently cured or waived, then repayment in full of all the borrowings then outstanding could become immediately due and payable. Such events of default include, without limitation, failing to pay borrowed amounts when due, failing to adhere to agreed upon financial covenants or failing to notify Bank of America of the occurrence of an event that could reasonably be expected to result in a material adverse effect upon the Company. Borrowings under the Credit Agreement can be used for general corporate purposes including capital expenditures, working capital, letters of credit and certain permitted acquisitions and investments. As of December 31, 2006 and 2005, the Company had zero and \$5.0 million outstanding under the Credit Agreement and was in compliance with all covenants of the Credit Agreement.

**9. Commitments and Contingencies**

*Operating Leases*

The Company leases its office space and certain equipment under non-cancelable operating leases with various terms through 2010. The minimum annual rent on the Company's office space is subject to increases based on stated rental adjustment terms, property taxes and operating costs, and contains rent concessions. For financial reporting purposes, rent expense is recognized on a straight-line basis over the term of the lease. Accordingly, rent expense recognized in excess of rent paid is reflected as deferred rent. Rental expense under operating leases in fiscal 2006, 2005 and 2004 was approximately \$3.3 million, \$3.0 million and \$2.0 million, respectively. The Company's office space lease contains incentives in the form of reimbursement from the landlord for a portion of the costs of leasehold improvements incurred by the Company which are recorded to rent expense on a straight-line basis over the term of the lease.

**NOVATEL WIRELESS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The minimum future lease payments under non-cancelable operating leases as of December 31, 2006 are as follows (in thousands):

	<u>Operating</u>
2007	\$ 1,895
2008	1,483
2009	1,516
2010	1,589
2011	88
Thereafter	—
Total minimum lease payments	<u>\$ 6,571</u>

*Royalties*

The Company has license agreements which commit it to royalty payments generally based on a percentage of the sales price of its products using certain technologies. The Company recognizes royalty obligations in accordance with terms of the respective royalty agreements. The Company has also accrued for royalty costs in cases where it does not have agreements by using its current best estimate of its obligation. These estimates are based on various market data information and other relevant information. If the Company enters into such agreements, or when additional market data becomes available, it will revise its estimates accordingly. In 2006, 2005 and 2004, the Company incurred royalty expense of \$13.6 million, \$11.3 million and \$8.7 million, respectively.

*Management Retention Agreements*

During 2005 and 2004, the Company entered into management retention agreements with the Company's named executive officers, other than its chief executive officer. The agreements entitle those employees to enumerated severance benefits if, within the one year period immediately following a change of control (as defined in the agreement) or at the direction of an acquirer in anticipation of such an event, the Company terminates the employee's employment other than for cause or disability or the employee terminates his or her employment for good reason. These severance benefits would include a lump sum payment of three times the sum of the employee's annual base salary then in effect and the applicable targeted annual bonus, continued employee benefits, full acceleration of vesting of the employee's stock options, a tax equalization payment to eliminate the effects of any applicable excise tax, and financial planning and outplacement services.

*Legal Matters*

The Company is, from time to time, party to various legal proceedings arising in the ordinary course of business. Based on evaluation of these matters and discussions with Company's counsel, the Company believes that liabilities arising from or sums paid in settlement of these existing matters will not have a material adverse effect on the consolidated results of operations or financial position.

In December 2006, the Company filed a complaint in U.S. District Court for the Southern District of California against a former supplier seeking damages for breach of contract. The supplier has contended that it was damaged by the Company and it is expected that the supplier will file a counter claim.

**10. Segment Information and Concentrations of Risk***Segment Information*

The Company operates in the wireless data modem technology industry and all sales of the Company's products and services are made in this segment. Management makes decisions about allocating resources based on this one operating segment.

The Company has operations in the United States, Canada and the United Kingdom. The amount of the Company's assets in the United States, Canada and the United Kingdom as of December 31, 2006 were \$172.8 million, \$18.0 million, and approximately \$835,000, respectively and as of December 31, 2005 were \$166.5 million, \$9.6 million and zero, respectively. For the year ended December 31, 2006, approximately 37% of revenues were derived from international customers (Europe/Middle East/Africa 27%, Asia/Australia 10%) as compared to approximately 58% of revenues derived from international customers (Europe/Middle East/Africa 55%, Asia/Australia 3%), for the year ended December 31, 2005. For the year ended December 31, 2004, approximately 76% of revenues were derived from international customers (Europe/Middle East/Africa 66%, Asia/Australia 10%).

*Concentrations of Risk*

Substantially all of the Company's revenue is derived from the sales of wireless access products. Any significant decline in market acceptance of the Company's products or in the financial condition of the Company's existing customers could impair the Company's ability to operate effectively.

A significant portion of the Company's revenue comes from a small number of customers. Two customers accounted for 38.2%, and 19.7% of 2006 revenues. Three customers accounted for 22.5%, 16.1%, and 14.4% of 2005 revenues. One customer accounted for 15.7% of 2004 revenues.

**11. Related Parties**

The Company has in the past sold products to and purchased products from AirLink Communications, Inc. (AirLink), a provider of fixed and mobile wireless data solutions. AirLink's Chairman and principal stockholder was also a member of our Board of Directors until March 11, 2004 and is a stockholder of the Company. Sales to AirLink were \$369,000 for the year ended December 31, 2004. Purchases by the Company from AirLink were \$662,000 for the year ended December 31, 2004. There were no sales to AirLink during 2006 or 2005, nor were there receivables from or payables to AirLink as of December 31, 2006 or December 31, 2005.

The Company has from time to time, sold products to a subsidiary of Chinatron Group Holdings Limited (Chinatron). Mr. Horst J. Pudwill, one of the Company's directors, is also a director of Chinatron and an affiliated company of Mr. Pudwill is a stockholder of Chinatron. In addition, the chairman and chief executive officer of Chinatron participated in private placement transactions, which were completed in 2003. Sales to Chinatron for the year ended December 31, 2004 was \$39,000. There were no sales to Chinatron during 2006 or 2005, nor were there receivables from Chinatron as of December 31, 2006 or December 31, 2005.

**12. Retirement Savings Plan**

The Company has a defined contribution 401(k) retirement savings plan (the "Plan"). Substantially all of the Company's U.S. employees are eligible to participate in the Plan after meeting certain minimum age and service requirements. Employees may make discretionary contributions to the Plan subject to Internal Revenue Service

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

limitations. Employer matching contributions amounted to \$427,000, \$274,000, and \$194,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Employer matching contributions vest over a four year period.

The Company has a Registered Retirement Savings Plan for its Canadian employees. Substantially all of the Company's Canadian employees are eligible to participate in the Plan. Employees make discretionary contributions to the plan subject to local limitations. Employer contributions amounted to \$77,000, \$113,000 and \$96,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

**13. Quarterly Financial Information (Unaudited)**

The following is a summary of unaudited quarterly results of operations for the years ended December 31, 2006 and 2005.

	Quarter			
	First	Second	Third	Fourth
	(in thousands, except per share amounts)			
<b>2006:</b>				
Total revenue	\$40,159	\$45,654	\$55,143	\$77,016
Gross margin	8,880	11,547	14,347	20,449
Net income (loss) applicable to common stockholders	(1,346)	95	(895)	2,589
Basic net earnings per common share	(0.05)	0.00	(0.03)	0.09
Diluted net earnings per common share	(0.05)	0.00	(0.03)	0.09
<b>2005:</b>				
Total revenue	\$32,328	\$38,597	\$42,129	\$48,683
Gross margin	10,656	11,828	13,139	10,546
Net income applicable to common stockholders	2,652	2,892	5,451	121
Basic net earnings per common share	0.09	0.10	0.19	0.00
Diluted net earnings per common share	0.09	0.10	0.18	0.00

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
Novatel Wireless, Inc. and subsidiaries:

We have audited the accompanying consolidated balance sheets of Novatel Wireless, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006. In connection with our audits of the consolidated financial statements, we also have audited financial statement Schedule II. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement Schedule II based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Novatel Wireless, Inc. and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement Schedule II, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Novatel Wireless' internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 16, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

San Diego, California  
March 16, 2007

SCHEDULE II

NOVATEL WIRELESS INC.

Valuation and Qualifying Accounts  
For the Years Ended December 31, 2006, 2005 and 2004 (in thousands):

	<u>Balance At Beginning of Year</u>	<u>Additions Charged to Operations</u>	<u>Deductions From Reserves</u>	<u>Balance At End of Year</u>
<b>Allowance for Doubtful Accounts:</b>				
December 31, 2006	\$ 96	\$ 635	\$ 100	\$ 631
December 31, 2005	105	19	28	96
December 31, 2004	311	—	206	105
<b>Warranty and Sales Returns Allowance:</b>				
December 31, 2006	665	2,157	1,263	1,559
December 31, 2005	404	444	183	665
December 31, 2004	25	382	3	404
<b>Deferred Tax Asset Valuation Allowance:</b>				
December 31, 2006	5,207	—	2,829	2,378
December 31, 2005	67,543	—	62,336	5,207
December 31, 2004	66,006	1,657	120	67,543

## EXHIBIT INDEX

The following Exhibits are filed as part of, or incorporated by reference into, this Report on Form 10-K:

<u>Exhibit Number</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 27, 2001).
3.2	Certificate of Amendment to Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2002, filed on November 14, 2002).
3.3	Certificate of Amendment to Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.2 to the Company's Amendment No. 1 to Form 10-K on Form 10-K/A for the year ended December 31, 2003, filed March 31, 2004).
3.4	Amended and Restated Certificate of Designation of Series A Convertible Preferred Stock (incorporated by reference to Exhibit 3.4 to the Company's Amendment No. 1 to Form 10-K on Form 10-K/A for the year ended December 31, 2003, filed March 31, 2004).
3.5	Certificate of Designation of Series B Convertible Preferred Stock (incorporated by reference to Exhibit 3.5 to the Company's Amendment No. 1 to Form 10-K on Form 10-K/A for the year ended December 31, 2003, filed March 31, 2004).
3.6	Bylaws (incorporated by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 27, 2001).
4.1	Amended and Restated Registration Rights Agreement, dated as of June 15, 1999, by and among the Company and certain of its stockholders (incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
4.2	Amended and Restated Investors' Rights Agreement, dated as of June 30, 2000, by and among the Company and certain of its stockholders (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
4.3	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
4.4	Form of Preferred Stock and Warrant Purchase Agreement entered into in connection with the Company's 2001 Series A Convertible Preferred Stock Financing (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed January 18, 2002).
4.5	Registration Rights Agreement dated as of September 12, 2002 by and among the Company and certain of its stockholders (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed October 21, 2002).
4.6	Form of Securities Purchase Agreement entered into in connection with the Company's 2003 Series B Convertible Preferred Stock Financing (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed March 28, 2003).
4.7	Registration Rights Agreement entered into in connection with the Company's 2003 Series B Convertible Preferred Stock Financing (incorporated by reference to Exhibit 4.8 to the Company's Current Report on Form 8-K, filed March 28, 2003).
4.8	Securities Purchase Agreement entered into in connection with the Company's January 2004 Common Stock and Warrant Financing Transaction (incorporated by reference to Exhibit 10.20 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003, filed March 15, 2004).

**Exhibit  
Number****Description**

4.9	Registration Rights Agreement entered into in connection with the Company's January 2004 Common Stock and Warrant Financing Transaction (incorporated by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003, filed March 15, 2004).
4.10	Form of Common Stock Purchase Warrant issued in connection with the Company's January 2004 Common Stock and Warrant Financing Transaction (incorporated by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003, filed March 15, 2004).
10.1	Amended and Restated 1997 Employee Stock Option Plan ("1997 Plan") (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
10.2	Amended and Restated Novatel Wireless, Inc. 2000 Stock Incentive Plan ("2000 Plan") (incorporated by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.3	Form of Executive Officer Stock Option Agreement under the 2000 Plan (incorporated by reference to Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.4	Form of Director Stock Option Agreement under the 2000 Stock Incentive Plan (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.5	Form of Amendment of Stock Option Agreements dated July 20, 2006 by and between the Company and Optionee with respect to the 1997 Plan (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed November 9, 2006).
10.6	Form of Amendment of Stock Option Agreements dated July 20, 2006 by and between the Company and Optionee with respect to the 2000 Plan (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed November 9, 2006).
10.7	Form of Amendment of Stock Option Agreements dated July 20, 2006 by and between the Company and Optionee with respect to the 2000 Plan and grants made pursuant thereto in 2004 and subsequently (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2006, filed November 9, 2006).
10.8	Amended and Restated Novatel Wireless, Inc. 2000 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.5 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.9	Form of Restricted Share Award agreement for restricted stock granted to non-employee Directors (incorporated by reference to Exhibit 10.10 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2006, filed August 9, 2006).
10.10	Form of Restricted Share Award agreement for restricted stock granted to executive officers (incorporated by reference to Exhibit 10.11 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2006, filed August 9, 2006).
10.11	Form of 2006 Management Bonus Plan (incorporated by reference to Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2006, filed August 9, 2006).

<u>Exhibit Number</u>	<u>Description</u>
10.12	Form of Indemnification Agreement by and between the Company and each of its executive officers and directors (incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-1 (No. 333-42570), filed November 14, 2000, as amended).
10.13	Form of Change of Control Letter Agreement by and between the Company and certain of its executive officers (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed August 16, 2004).
10.14	Form of Executive Officer Bonus Plan (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2005, filed May 10, 2005).
10.15	Credit Agreement, dated December 29, 2005, by and between Bank of America, N.A. and the Company (incorporated by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
10.16	Executive Chairman Agreement, dated October 19, 2006, by and between Peter V. Leparulo and the Company (incorporated by reference to Exhibit 99.3 to the Company's Current Report on Form 8-K, filed October 24, 2006).
21	Subsidiaries of Novatel Wireless, Inc. (incorporated by reference to Exhibit 21 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005, filed March 16, 2006).
23.1	Consent of KPMG LLP, Independent Registered Public Accounting Firm.*
24	Power of Attorney (See signature page).
31.1	Certification of our Chief Executive Officer adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of our Chief Financial Officer adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

\* Filed electronically herewith

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors  
Novatel Wireless, Inc.:

We consent to the incorporation by reference in the registration statements (Nos. 333-139730 and 333-53692) on Form S-8 and (Nos. 333-114116, 333-112857, 333-109321, 333-81190, and 333-100633) on Form S-3 of Novatel Wireless, Inc. and subsidiaries of our reports dated March 16, 2007, with respect to the consolidated balance sheets of Novatel Wireless, Inc. as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows, and the related financial statement Schedule II, for each of the years in the three-year period ended December 31, 2006, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2006, and the effectiveness of internal control over financial reporting as of December 31, 2006, which reports appear in the December 31, 2006 annual report on Form 10-K of Novatel Wireless, Inc.

Our report refers to the Company's adoption of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, effective January 1, 2006.

/s/ KPMG LLP

San Diego, California  
March 16, 2007

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**  
**Pursuant to Rule 13a-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Brad Weinert, certify that:

1. I have reviewed this annual report on Form 10-K of Novatel Wireless, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ BRAD WEINERT

**Brad Weinert**  
**Acting Chief Executive Officer and Chief Operating Officer (Principal Executive Officer)**

Dated: March 16, 2007

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**  
**Pursuant to Rule 13a-14(a) adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Dan L. Halvorson, certify that:

1. I have reviewed this annual report on Form 10-K of Novatel Wireless, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DAN L. HALVORSON

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Dan L. Halvorson  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)

Dated: March 16, 2007

## CERTIFICATIONS

Brad Weinert, Acting Chief Executive Officer and Chief Operating Officer of Novatel Wireless Inc. (the "Company"), and Dan L. Halvorson, Chief Financial Officer and Treasurer of the Company, each hereby certifies pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. Section 1350) that, to the best of his knowledge:

1. The Annual Report on Form 10-K of the Company for the year ended December 31, 2006 fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and

2. The information contained in the Annual Report on Form 10-K of the Company for the year ended December 31, 2006 fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Annual Report and the results of operations of the Company for the period covered by the Annual Report.

**IN WITNESS WHEREOF**, the undersigned have set their hands hereto as of the 16th day of March, 2007.

/s/ BRAD WEINERT

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**Brad Weinert**  
Acting Chief Executive Officer and Chief Operating Officer (Principal  
Executive Officer)

/s/ DAN L. HALVORSON

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**Dan L. Halvorson**  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)