UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2004

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)**

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 or incorporation or organization)**	**86-0824673** **(I.R.S. Employer Identification No.)**
9255 Towne Centre Drive, Suite 225, San Diego, CA **(Address of principal executive offices)**	**92121** **(zip code)**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒.

The number of shares of the Registrant’s common stock outstanding as of October 31, 2004 was 28,675,896.

As used in this report on Form 10-Q, unless the context otherwise requires, the terms “we,” “us,” “our,” “the Company” and “Novatel Wireless” refer to Novatel Wireless, Inc., a Delaware corporation and its wholly-owned subsidiaries.

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: increasing 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 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; and our general business and strategy, including plans and expectations relating to technology, product development, strategic relationships, customers, manufacturing, service activities and international expansion. The words “anticipate,” “believe,” “expect,” “intend,” “plan,” “project,” “will” and similar words and phrases are also intended to identify forward-looking statements.

Forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those anticipated in such forward-looking statements as a result of certain factors, as more fully described elsewhere in this report. For a detailed discussion of these risks and uncertainties, see the “Risks Related to Our Business” section of this Form 10-Q. 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

The Novatel Wireless logo, “Merlin,” “MobiLink,” “Freedom Box,” and “Expedite,” are U.S. trademarks of Novatel Wireless, Inc. and the Company has applied for trademarks for “Ovation” and “Conversa” in the U.S. and elsewhere. Other trademarks, trade names or service marks used in this report are the property of their respective owners.

PART I – FINANCIAL INFORMATION

Item 1. ***Financial Statements***

NOVATEL WIRELESS, INC.

CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 39,966,000	$ 3,942,000
Marketable securities	25,172,000	—
Restricted cash	—	635,000
Accounts receivable, net of allowance for doubtful accounts of $140,000 and $311,000 in 2004 and 2003, respectively	8,845,000	8,986,000
Accounts receivable — related parties	—	399,000
Inventories	4,623,000	2,349,000
Prepaid expenses and other	1,598,000	1,378,000
Total current assets	80,204,000	17,689,000
Property and equipment, net	4,307,000	1,915,000
Marketable securities	24,668,000	—
Intangible assets, net	4,701,000	4,629,000
Other assets	110,000	188,000
	$ 113,990,000	$ 24,421,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 10,607,000	$ 6,730,000
Accrued expenses	6,826,000	1,179,000
Restructuring accrual	936,000	1,222,000
Deferred revenues	1,821,000	6,218,000
Capital lease obligations	1,634,000	82,000
Total current liabilities	21,824,000	15,431,000
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value $.001, 2,000,000 shares authorized:		
Convertible Series A preferred stock amended in 2003, 0 and 1,025 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	—	—
Convertible Series B preferred stock, 0 and 4,703 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	—	—
Common stock, par value $.001, 50,000,000 shares authorized, 28,449,229 and 12,737,640 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	28,000	13,000
Additional paid-in capital	330,899,000	256,253,000
Accumulated other comprehensive loss	(133,000)	—
Deferred stock compensation	—	(142,000)
Accumulated deficit	(238,628,000)	(247,134,000)
Total stockholders' equity	92,166,000	8,990,000
	$ 113,990,000	$ 24,421,000

See accompanying notes to unaudited consolidated financial statements.

NOVATEL WIRELESS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003 As restated (see Note 2)	Nine Months Ended September 30, 2004	Nine Months Ended September 30, 2003 As restated (see Note 2)
Revenue	$31,018,000	$ 8,063,000	$70,278,000	$ 23,211,000
Cost of revenue	20,706,000	5,873,000	47,905,000	20,111,000
Gross margin	10,312,000	2,190,000	22,373,000	3,100,000
Operating costs and expenses:				
Research and development	2,913,000	1,375,000	7,247,000	4,556,000
Sales and marketing	1,320,000	617,000	3,116,000	1,906,000
General and administrative	1,354,000	814,000	3,553,000	2,833,000
Restructuring charges	—	176,000	—	414,000
Amortization of deferred stock compensation (*)	14,000	82,000	141,000	663,000
Total operating costs and expenses	5,601,000	3,064,000	14,057,000	10,372,000
Operating income (loss)	4,711,000	(874,000)	8,316,000	(7,272,000)
Other income (expense):				
Interest income	291,000	35,000	448,000	36,000
Interest expense	(29,000)	(823,000)	(30,000)	(2,547,000)
Other income (expense), net	(46,000)	(86,000)	(83,000)	(1,000)
Net income (loss)	$ 4,927,000	$(1,748,000)	$ 8,651,000	$ (9,784,000)
Accretion of dividends and beneficial conversion features pertaining to preferred stock	—	(24,000)	(145,000)	(4,869,000)
Net income (loss) applicable to common stockholders	$ 4,927,000	$(1,772,000)	$ 8,506,000	$(14,653,000)
Per share data:				
Net income (loss) per common share:				
Basic	$ 0.18	$ (0.22)	$ 0.38	$ (1.99)
Diluted	$ 0.16	$ (0.22)	$ 0.31	$ (1.99)
Weighted average shares used in computation of basic and diluted net income (loss) per common share:				
Basic	28,116,307	7,986,148	22,377,041	7,375,564
Diluted	30,564,095	7,986,148	28,116,949	7,375,564
(*) Amortization of deferred stock compensation:				
Cost of revenue	$ 2,000	$ 10,000	$ 18,000	$ 45,000
Research and development	4,000	27,000	44,000	115,000
Sales and marketing	5,000	28,000	47,000	118,000
General and administrative	3,000	17,000	32,000	385,000
	$ 14,000	$ 82,000	$ 141,000	$ 663,000

See accompanying notes to unaudited consolidated financial statements.

NOVATEL WIRELESS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
	2004	2003
		As restated (see Note 2)
Cash flows from operating activities:		
Net income (loss)	$ 8,651,000	$(9,784,000)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,642,000	2,935,000
Inventory write down	131,000	1,960,000
Accretion of interest expense on convertible notes	—	2,333,000
Compensation for stock options issued below fair value	141,000	663,000
Provision for bad debts	—	92,000
Compensation for warrants issued in connection with convertible debt	—	79,000
Gain on sale of property and equipment	(26,000)	(85,000)
Changes in assets and liabilities:		
Restricted cash	635,000	30,000
Accounts receivable	141,000	994,000
Accounts receivable – related parties	399,000	36,000
Inventories	(2,405,000)	17,000
Prepaid expenses and other	(142,000)	548,000
Accounts payable	3,877,000	(364,000)
Accrued expenses	5,647,000	(543,000)
Inventory purchase commitments	—	(478,000)
Restructuring accrual	(286,000)	(569,000)
Deferred revenues	(4,397,000)	1,307,000
Net cash provided by (used in) operating activities	15,008,000	(829,000)
Cash flows from investing activities:		
Purchases of property and equipment	(1,556,000)	(41,000)
Proceeds from sale of property and equipment	30,000	116,000
Purchase of intangible assets	(1,525,000)	(100,000)
Short-term investment purchases	(25,200,000)	
Long-term investment purchases	(24,773,000)	—
Net cash used in investing activities	(53,024,000)	(25,000)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	68,473,000	—
Proceeds from exercise of stock options and warrants	5,956,000	1,927,000
Proceeds from shares issued under the employee stock purchase plan	89,000	—
Net proceeds from issuance of Series B convertible preferred stock	—	1,617,000
Net proceeds from issuance of convertible notes	—	1,095,000
Payments on line of credit borrowings	—	(2,234,000)
Payments under capital lease obligations	(478,000)	(126,000)
Net cash provided by financing activities	74,040,000	2,279,000
Net increase in cash and cash equivalents	36,024,000	1,425,000
Cash and cash equivalents, beginning of period	3,942,000	1,571,000
Cash and cash equivalents, end of period	$ 39,966,000	$ 2,996,000

See accompanying notes to unaudited consolidated financial statements.

	Nine Months Ended September 30,	
	2004	2003
Supplemental disclosures of non-cash investing and financing activities:		
Accretion of dividends on convertible and redeemable Series A preferred stock	—	$ 97,000
Accretion of dividends on Series A convertible preferred stock	$ 18,000	52,000
Capital lease obligations	2,030,000	75,000
Accretion of dividends on Series B preferred stock	127,000	—
Conversion of Series B preferred stock into shares of common stock	7,000	—
Amortization of offering costs for Series A convertible and redeemable preferred stock	—	177,000
Reclassification of convertible and redeemable Series A preferred stock to convertible Series A preferred stock	—	3,900,000
Deferred compensation adjustment for stock options cancelled	—	849,000
Issuance of convertible notes payable to settle the inventory purchase commitments liability	—	3,505,000
Deemed dividend for the imputed value assigned to the beneficial conversion feature on conversion of the Convertible Notes to Series B preferred stock and related common warrants	—	1,581,000
Accretion of imputed value assigned to the beneficial conversion feature on Series A convertible and redeemable preferred stock and related common stock warrants	—	2,962,000
Conversion of Series A preferred stock into shares of common stock	—	2,926,000
Conversion of convertible notes payable into Series B preferred stock	—	1,617,000
Imputed value assigned to beneficial conversion feature on convertible notes payable	—	3,594,000
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 30,000	$ 136,000

See accompanying notes to unaudited consolidated financial statements.

NOVATEL WIRELESS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The information contained herein has been prepared by Novatel Wireless, Inc. (the “Company”) in accordance with the rules of the Securities and Exchange Commission. The information at September 30, 2004 and for the three and nine month periods ended September 30, 2004 and 2003 is unaudited. The consolidated financial statements reflect all adjustments, consisting of only normal recurring accruals, which are, in the opinion of management, necessary for a fair statement of the results of the interim periods presented. These consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements and notes thereto included in the Company’s annual report on Form 10-K/A for the year ended December 31, 2003. The results of operations for the interim periods are not necessarily indicative of results to be expected for any other interim period or for the year as a whole.

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

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. Significant estimates include revenue recognition, inventory valuation, useful lives and the valuation of long–lived assets and restructuring and royalty accruals.

Recent Accounting Pronouncements

Effective as of the beginning of the first quarter of fiscal 2004, the Company adopted the revised interpretation of Financial Accounting Standards Board (FASB) Interpretation No. 46 (FIN 46(R)), “Consolidation of Variable Interest Entities,” (FIN 46(R)). FIN 46(R) requires that certain variable interest entities be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The Company does not have any investments in or arrangements with entities it believes are variable interest entities. The adoption of FIN 46(R) did not have any impact on the Company’s consolidated financial statements.

Stock Based Compensation

The Company accounts for stock options in accordance with the provisions of Accounting Principles Board (“APB”) *Opinion No. 25, “Accounting for Stock Issued to Employees,”* and related interpretations which recognizes compensation expense on the grant date if the then current market price of the stock exceeds the exercise price.

In December 2002, the FASB issued Statement of Financial Accounting Standard (“SFAS”) No. 148, “*Accounting for Stock-Based Compensation-Transition and Disclosure,”* an amendment to SFAS No. 123, “*Accounting for Stock-Based Compensation*.” This Statement provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Additionally, the Statement amends the disclosure requirements of SFAS No. 123, to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

In accordance with SFAS No. 123, the Company accounts for costs of stock-based employee compensation using the intrinsic value method prescribed in APB Opinion No. 25. Additionally, the Company discloses the pro forma effect on net loss and related per share amounts as if the fair-value method prescribed by SFAS No. 123 had been used to account for its stock-based employee compensation. The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and related interpretations. During the first nine months of 2004, the Company issued options to purchase an aggregate of 2,462,136 shares of the

Company's common stock to its employees and non-employee directors. The vesting schedule for 1,069,636 of these options is 20% at 6 months from the grant date and 1/30th of the remaining balance of the grant each month thereafter. The remaining option grants made during this period vest 25% at 1 year from the grant date and monthly thereafter for a total of 4 years. The weighted average exercise price of the options granted during the nine months ended September 30, 2004 was $16.89 per share. The weighted average fair value of the options granted during the nine months ended September 30, 2004 was estimated as $14.43 per share on the date of grant using the Black-Scholes option-pricing model. The following assumptions for the three and nine months ended September 30, 2004 and September 30, 2003 option grants have been made: risk-free interest rates between 2.58% and 3.29%, dividend yields of 0%, expected volatility of 156.1%, 148.8%, 122.6%, and 122.6%, respectively, and an expected life of the option of four years.

Had compensation expense been determined based on the fair value method at the dates of grant for the quarterly periods ended September 30, 2004 and 2003 consistent with the provisions of SFAS No. 123, as amended by SFAS No. 148, the Company's net income (loss) per share would have been reported as the pro forma amounts indicated below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
		As restated (see Note 2)		As restated (see Note 2)
Net income (loss) applicable to common stockholders, as reported	$4,927,000	$(1,772,000)	$8,506,000	$(14,653,000)
Net income (loss) applicable to common stockholders, pro forma	$1,670,000	$(3,166,000)	$1,272,000	$(16,666,000)
Net income (loss) per share, as reported – Basic	$ 0.18	$ (0.22)	$ 0.38	$ (1.99)
Net income (loss) per share, pro forma – Basic	$ 0.06	$ (0.40)	$ 0.06	$ (2.26)
Net income (loss) per share, as reported – Diluted	$ 0.16	$ (0.22)	$ 0.31	$ (1.99)
Net income (loss) per share, pro forma – Diluted	$ 0.05	$ (0.40)	$ 0.05	$ (2.26)

2. Restatement of 2003 Results

In March 2004, subsequent to the original issuance of the Company's 2003 financial statements on Form 10-K, as filed with the SEC on March 15, 2004, the Company determined it had not accounted for the beneficial conversion feature on its then outstanding Series A preferred stock in accordance with Generally Accepted Accounting Principles. Accordingly, the Company restated its consolidated financial statements for those periods on Form 10-K/A to amend and restate the fiscal year ended December 31, 2003 to correct this misstatement.

As a result of this restatement, net loss applicable to common stockholders in the accompanying statements of operations for three months ended September 30, 2003 has been decreased by $978,000, from a loss of $2.8 million as previously reported to a loss of $1.8 million, as restated, respectively. For the nine months ended September 30, 2003 net loss applicable to common stockholders has been increased by $728,000, from a loss of $13.9 million as previously reported to a loss of $14.7 million, as restated. This change in net loss applicable to common stockholders represents the deemed dividend recognized during the period for the remaining value of the unaccreted beneficial conversion feature and offering costs. Accordingly, loss per common share in the accompanying statements of operations for the three months ended September 30, 2003 has been decreased by $0.12, from a loss of $0.34 per share as previously reported to a loss of $0.22 per share as restated, respectively. For the nine months ended September 30, 2003 the loss has been increased by $0.10, from a loss of $1.89 per share as previously reported to a loss of $1.99 per share as restated, respectively. Further discussion of the correction appears in Note 6 to the Company's audited consolidated financial statements for the year ended December 31, 2003 on Form 10-K/A.

3. Recent Operational Developments and Balance Sheet Details

Operational Overview

In May 2004, the Company completed an equity offering, raising approximately $61.0 million, net of offering costs and underwriters' commissions (see note 6). At September 30, 2004, the Company had approximately $89.9 million in cash and cash equivalents and marketable securities on hand.

During the first quarter of 2004, the Company reached profitability for the first time since its inception and has recorded net income applicable to common stockholders of $8.5 million for the nine months ended September 30, 2004. The Company had previously incurred significant costs to develop its technologies and products, which exceeded total revenue. The Company had incurred losses in each year since inception through the end of 2003. As of September 30, 2004, the Company had an accumulated deficit of $238.6 million and working capital of $58.4 million.

In January 2004, the Company raised $7.5 million, net of offering costs, from the issuance of 1,142,855 shares of common stock (see note 6).

Nasdaq National Market Listing

On April 29, 2004, the Company transferred the listing of its common shares back to the Nasdaq National Market. The Company's common shares had traded on the Nasdaq SmallCap Market since April 8, 2003, as it previously did not meet Nasdaq's $10 million minimum stockholders' equity requirement for continued listing on the National Market on which its common stock had been listed since the Company's initial public offering in November 2000.

Restructuring Charges

As a result of the previous adverse economic developments in the Company's industry sector, the Company had continuously reduced its operating costs, primarily through employee layoffs and facility consolidations, throughout 2001, 2002 and 2003. Consequently, restructuring charges were recorded totaling $828,000 in 2003, $2.7 million in 2002 and $7.1 million in 2001. No restructuring charges were recorded during the three and nine months ended September 30, 2004. During the nine months ended September 30, 2003, the Company recorded a restructuring charge of $414,000, primarily as a result of eight employee separations. There were no employee separations in 2004 as a result of restructuring activities. The remaining accrual at December 31, 2003 and September 30, 2004 consists solely of facility closing costs.

The following table displays the activity and balances of the restructuring accrual from January 1, 2004 through September 30, 2004:

Balance – January 1, 2004	$1,222,000
Cash payments	(286,000)
Balance – September 30, 2004	$ 936,000

Cash payments for facility closings of $936,000 are expected to be paid ratably over the next 36 months.

Inventories

Inventories consist of the following:

	September 30, 2004	December 31, 2003
Finished goods	$ 1,248,000	$1,576,000
Raw materials and components	3,375,000	773,000
	$ 4,623,000	$2,349,000

Accrued Expenses

Accrued expenses consist of the following:

	September 30, 2004	December 31, 2003
Royalties	$ 3,790,000	$ 493,000
Payroll and related	1,808,000	442,000
Product warranty and sales returns reserve	339,000	25,000
Professional fees	164,000	75,000
Other	725,000	144,000
	$ 6,826,000	$1,179,000

4. Earnings (Loss) Per Share

Earnings (Loss) Per Share – Basic earnings (loss) 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 (convertible subordinated notes, warrants to purchase common stock and common stock options using the treasury stock method) 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.

The following table sets forth the computation of diluted weighted average common and potential common shares outstanding for the three and nine months ended September 30, 2004 and 2003, respectively.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Basic weighted average common shares outstanding	28,116,307	7,986,148	22,377,041	7,375,564
Effect of dilutive securities:				
Warrants	300,227	—	443,376	—
Options	2,147,561	—	2,103,141	—
Series A Preferred Stock	—	—	30,411	—
Series B Preferred Stock	—	—	3,162,980	—
Diluted weighted average common and potential common shares outstanding	30,564,095	7,986,148	28,116,949	7,375,564

Weighted average options and warrants to purchase a total of 4,666,877 and 4,491,804 shares of common stock for the three and nine months ended September 30, 2004, respectively, and 5,895,668 and 2,318,267 shares of common stock for the three and nine months ended September 30, 2003, respectively, were outstanding but not included in the computation of diluted earnings per share as their effect was anti-dilutive.

5. 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 and Canada. The amount of the Company's assets in the United States and Canada as of September 30, 2004 are $111.7 million and $2.3 million, respectively, and as of December 31, 2003 were $22.6 million and $1.8 million, respectively.

Concentrations of Risk

Substantially all of the Company's revenues come from the sale of wireless Internet products. Any material decline in market acceptance of the Company's products or a material decline 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. For the three months ended September 30, 2004 two customers accounted for 17.9% and 13.5% of revenues. Two customers accounted for 57.7%, and 16.8% of revenues for the three months ended September 30, 2003. Two customers accounted for 16.0% and 11.9% of revenues for the nine months ended September 30, 2004. Two customers accounted for 64.7% and 15.6% of revenues for the nine months ended September 30, 2003. Certain end customers have purchased the Company's products through strategic relationships with Lucent Technologies and Sprint PCS.

6. Stockholders' Equity

Recent Financings and Equity Activity

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 4,516 shares of the Company's Series B preferred stock, including accrued dividends, were converted into 6,782,858 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. Resale of the shares issued in this offering and the shares issuable upon exercise of the accompanying common stock purchase warrants was registered on a registration statement on Form S-3, which the SEC declared effective on March 18, 2004.

Series B Preferred Stock

During the first half of 2004, the remaining 4,703 shares of Series B preferred stock, which the Company issued in 2003 private placement, including accrued dividends, were converted into 7,059,127 shares of common stock. As a result, during the first half of 2004, the Company accrued approximately $127,000 in dividends relating to the outstanding Series B preferred stock prior to their conversions.

Series A Preferred Stock

During the first quarter of 2004, the remaining 1,025 shares of Series A preferred stock, which the Company issued in a 2001 private placement, including accrued dividends, were converted into 102,558 shares of common stock. As a result, there are no shares of Series A preferred stock outstanding. During the first quarter of 2004, the Company accrued approximately $18,000 in dividends relating to the outstanding Series A preferred stock prior to their conversion.

Stock Options and Warrants

During the nine months ended September 30, 2004, options to purchase 1,357,215 shares of common stock were exercised at a weighted average price of $2.96 per share. As a result of these option exercises, the Company received proceeds of approximately $4.0 million.

During the nine months ended September 30, 2004, warrants to purchase 1,794,117 shares of common stock were exercised at a weighted average price of $1.10 per share. As a result of these warrant exercises, the Company received proceeds of approximately $2.0 million.

On April 29, 2004, the Board of Directors of the Company authorized and approved the issuance to the Company's executive officers a total of 850,000 options to purchase shares of the Company's common stock at an exercise price of $16.27 per share, which was the fair market value of the Company's common stock on the date of this grant. The Options were issued pursuant to the Company's Amended and Restated 2000 Stock Incentive Plan (the "Plan").

Net income (loss) applicable to common stockholders

A reconciliation of the net income (loss) applicable to common stockholders follows:

	Three Months ended September 30,		Nine Months ended September 30,	
	2004	2003	2004	2003
		As restated (see Note 2)		As restated (see Note 2)
Net income (loss)	$4,927,000	$(1,748,000)	$8,651,000	$ (9,784,000)
Adjustments to net income (loss) used in computing basic and diluted net loss applicable to common stockholders:				
Deemed dividend for the imputed value assigned to the beneficial conversion feature on conversion of the Convertible Notes to Series B preferred stock and related common stock warrants	—	—	—	(1,581,000)
Accretion of dividends on Series A convertible and redeemable preferred stock	—	(6,000)	—	(97,000)
Accretion of dividends on Series A convertible preferred stock	—	(18,000)	(18,000)	(52,000)
Accretion of dividends on Series B convertible preferred stock	—	—	(127,000)	—
Amortization of offering costs for convertible and redeemable pre preferred stock	—	—	—	(177,000)
Accretion of imputed value assigned to the beneficial conversion feature on Series A convertible and redeemable preferred stock and related common stock warrants	—	—	—	(2,962,000)
Total	—	(24,000)	(145,000)	(4,869,000)
Net income (loss) applicable to common stockholders	$4,927,000	$(1,772,000)	$8,506,000	$(14,653,000)

7. Line of Credit

The Company had been party to an accounts receivable purchase facility with a bank, which had allowed it to borrow, at any given time, up to the lesser of $6.7 million or 75.0% of certain eligible accounts receivable balances. The Company canceled this facility in July 2004.

In connection with initially entering into this facility, the Company issued warrants to purchase 58,762 shares of the Company's common stock at an exercise price of $7.06 per share, as adjusted to date to reflect dilutive equity issuances made subsequent to November 2001, the initial date of the facility. The fair value of the warrants totaling $358,000 was amortized as interest expense over the initial 12-month term of the facility. In February 2004, all of these warrants were exercised using a cashless feature. A total of 33,996 common shares were issued as a result of this exercise.

8. Commitments and Contingencies

Employment Agreements

In August 2004, the Company entered into management retention agreements with the Company's named executive officers. The agreements entitle those employees to enumerated severance benefits if, within the one year period immediately following a change of control (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 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.

9. Income Taxes

The Company has historically generated tax net operating losses. Accordingly, the Company has net operating loss carryovers that may be used to offset future income. Internal Revenue Code (IRC) Section 382 provides that a company's net operating losses may be limited upon an ownership change. Assuming that there was an ownership change as defined in IRC Section 382 during this period of losses, a tax value computation would need to be made as of any ownership change dates to determine the applicable annual limitation applied to the utilization of the Company's net operating loss carryovers. While the Company does not believe that the limitations, if any, would impair the Company's ability to use its net operating losses to offset current forecasted taxable income for the year ending December 31, 2004, the extent of such limitations has not yet been determined for future periods. The Company is in the process of completing a formal IRC Section 382 study and analysis.

10. Related Parties

The Company sells products to AirLink Communications, Inc. (AirLink), a wireless software infrastructure business, which integrates the Company's modems into their products. 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 for the three and nine months ended September 30, 2004 were $10,000 and $397,000, respectively, and were $27,000 and $34,000, for the three and nine months ended September 30, 2003, respectively. Purchases from Airlink were $228,000 and $602,000 for the three and nine months ended September 30, 2004, respectively. There were no purchases from AirLink for the three and nine months ended September 30, 2003. There were no receivables due from AirLink as of September 30, 2004. There were no payables due to AirLink as of September 30, 2004.

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 and principal stockholders is also a director and stockholder of Chinatron. In addition, the chairman and chief executive officer of Chinatron participated in private placement transactions, which were completed in 2003 (the 2003 Private Placement). Sales to Chinatron for the three and nine months ended September 30, 2004 were $0 and $39,000, respectively. Sales to Chinatron for three and nine months ended September 30, 2003 were $522,000 and $939,000, respectively. There were no receivables due from Chinatron as of September 30, 2004.

Cornerstone Equity Investors, LLC (Cornerstone), a private equity investment firm that is one of the Company's principal stockholders, participated as an investor in the 2003 Private Placement. Messrs. Mark Rossi and Robert Getz, two of the Company's directors since December 1999, are managing directors of Cornerstone. Mr. Peter V. Leparulo, the Company's chief executive officer since January 13, 2003 and member of the Company's board since May 7, 2003, also participated as an investor in the 2003 Private Placement.

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

The following information should be read in conjunction with the consolidated financial statements and the accompanying notes included in Item 1 of this quarterly report, as well as the audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2003 contained in our 2003 annual report on Form 10-K/A.

Overview and Background

We are a provider of wireless broadband access solutions for the worldwide mobile communications market. Our broad range of products includes wireless data modems and software for laptop PCs, embedded wireless modules for original equipment manufacturers, or OEMs, and ruggedized wireless data modems for public safety and telemetry applications. 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 access to data including corporate, public and personal information through the Internet and enterprise networks. We also offer software engineering and design services to our customers to facilitate the use of our products.

During the first quarter of 2004, we reached profitability for the first time since our inception and recorded net income applicable to common stockholders of $413,000. Since then, we have continued to execute on our plan to improve our operating results and financial condition and recorded net income applicable to common stockholders for the nine months ending September 30, 2004 of $8.5 million. Historically, we have incurred substantial costs to develop our technology and products, and to recruit and train personnel for our product development and sales and marketing departments. In the past, our operating expenses have exceeded the revenue generated by our products and services. As a result, we have incurred losses in each quarter since inception through the fourth quarter of 2003. As of September 30, 2004, we had an accumulated deficit of $238.6 million and working capital of $58.4 million.

Since our inception in 1996, we have been focused on the development and commercialization of technologies that allow for wireless access to data. We expanded our operations in advance of the launch of several new products in the late 1990s through 2001. Beginning in 2001, in response to the decline in the telecommunications industry, we implemented an operational and organizational restructuring to increase operating efficiency and conserve working capital. These restructuring activities included facility consolidations, reduction of employee staff, consultants and temporary labor and critical assessments of asset impairment and obsolete inventory. For 2003 and 2002, we incurred restructuring and impairment charges of approximately $800,000 and $2.7 million, respectively. No restructuring and impairment charges were recorded during 2004.

Beginning in early 2003, we also aggressively pursued the development of innovative 3G products, refocused our research and development efforts on sales driven customer needs and focused our sales, marketing and distribution efforts on large wireless operators and related companies.

These efforts have contributed to an increase in our gross margin from a negative $33.8 million for 2001 to a positive gross margin of $5.9 million for 2003 and $22.4 million for the nine months ended September 30, 2004, and an improvement in our gross margin percentage from negative 77.4% in 2001 to positive 33.2% for the three months ended September 30, 2004 and 31.8% for the nine months ended September 30, 2004. We also reduced our operating loss from $28.0 million for 2002 to an operating loss of $7.8 million for 2003 and became profitable in the first quarter of 2004. For the nine months ended September 30, 2004 we recorded net income applicable to common stockholders of $8.5 million.

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 to networks;
- use of the Internet;
- rate of change to new products;
- loss of significant customers;
- drop in demand for CDMA and UMTS products; and
- change in technologies.

We began shipping our first 3G products in December 2003 and anticipate introducing additional 3G products in the fourth quarter of 2004 and early 2005. In the future, we also expect to enter into customer contracts for development services, but not at significant levels in relation to total revenue. Certain end customers have purchased our products through our strategic relationships with Lucent Technologies and Sprint PCS.

Cost of Revenue. We currently outsource all of our manufacturing operations to LG Innotek and Celestica. All costs associated with these manufacturers are included in our cost of revenue. Cost of revenue also includes warranty costs, amortization of intangible licenses, royalty payments 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 2003 and 2002, we recorded inventory write-downs of $2.0 million and $2.5 million, respectively, due to the decrease in demand for our products. Inventory write-downs of approximately $100,000 were recorded during the nine months ended September 30, 2004. 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 as expected, 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 in future periods to incur these expenses in periods prior to recognizing revenue from these contracts. In addition, the portion of our revenue derived from international sales has increased, requiring an expansion of our sales and marketing efforts in these markets.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Significant estimates include revenue recognition, inventory valuation, allowance for doubtful accounts receivable, useful lives and valuation of intangible and long–lived assets and estimates for costs recorded in restructuring and royalty accruals.

Revenue Recognition. Our revenue is generated from the sale of our broadband wireless access solutions to wireless operators, OEM customers, VARs and distributors. Revenue from product sales is recognized upon the later of transfer of title or shipment of the product to the customer. We record deferred revenue for cash payments received from customers in advance of product shipments. We establish reserves for estimated product returns allowances in the period in which revenue is recognized. In estimating our future product returns, we consider various relevant factors, including our stated return policies and practices and our historical trends.

For our fixed price development services contracts, we recognize revenue as services are rendered using labor output measures or the achievement of milestones as indicators of progress. Total estimated costs are 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 our estimated costs materially change, our 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.

During 2003, we amended a joint development agreement containing multiple elements with one of our customers including development services and product shipments. Accordingly, we have separated the deliverables into units of accounting and allocated arrangement consideration to these deliverables in accordance with the provisions of Emerging Issues Task Force (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 were deferred and is being recognized as revenue when products are shipped or as development services are performed.

Allowance for Doubtful Accounts. We provide an allowance against our receivables 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, changes in customer payment cycles and our customer’s 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 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 might be required. We have not experienced significant variances in the past between our estimated and actual doubtful accounts and anticipate that we will be able to continue to make reasonable estimates in the future.

Inventory Valuation. Inventories are stated at 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, obsolete and impaired 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.

We believe that the estimates we use in calculating the inventory reserve are reasonable and properly reflect the risk of excess and obsolete inventory. If customer demand for our inventory is substantially different from our estimates, adjustments to our inventory reserve may be required, which could have a material adverse effect on our consolidated financial statements.

Warranty Costs. We accrue warranty costs based on estimates of future warranty related repairs or rework of products. Our warranty policy generally provides one- or two-year coverage for products following the date of purchase. Our policy is to accrue the estimated cost of warranty coverage at the time the sale is recorded. In estimating our future warranty obligations we consider various relevant factors, including the historical frequency of claims and the cost to replace or repair products under warranty. We have not experienced significant variances in the past between our estimated and actual warranty costs. We have not experienced significant warranty expenses to date. Future expenses could be different, depending on the quality of our product design and manufacturing quality.

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 the fair value, which is 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 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 will continue to 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.

Royalty Costs. We have license agreements which commit us to royalty payments based on a percentage of the sales of our products using certain technologies. We recognize royalty obligations in accordance with terms of the respective royalty agreements. We have accrued for royalty costs where agreements have not been finalized using our current best estimate of our obligation. These estimates are based on various market data information and other relevant information. When the agreements are finalized, we will revise our estimates accordingly.

Results of Operations

Three Months Ended September 30, 2004 Compared to Three Months Ended September 30, 2003

Revenue. Revenue for the three months ended September 30, 2004 increased $22.9 million, or 285%, to $31.0 million compared to $8.1 million for the same period in 2003. The overall increase in product sales of approximately $23.5 million was attributable primarily to higher sales volumes resulting from our introduction of new products and the increased demand for wireless products and wireless access services during 2004. Revenue recognized for development services decreased $600,000, or 39%, to $900,000 for the three months ended September 30, 2004 compared to $1.5 million for the same period in 2003. 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 three months ended September 30, 2004 increased $14.8 million, or 253%, to $20.7 million compared to $5.9 million for the same period in 2003. The increase in cost of revenue was attributable to an $11.7 million increase in product shipment costs, an increase in royalty costs of approximately $2.3 million, an increase in manufacturing overhead costs of approximately $500,000 and an increase in amortization of software licenses of approximately $300,000. Cost of revenue related to products increased due to the increase in the demand for our products as described above. Total cost of revenue for development services during 2004 and 2003 amounted to $700,000 and $800,000, respectively. Cost of revenue for the three months ended September 30, 2004 includes a $100,000 inventory charge for excess and obsolete inventory, primarily related to products that were no longer being manufactured.

Gross margin. Gross margin for the three months ended September 30, 2004 increased by $8.1 million, or 371% to $10.3 million compared to gross margin of $2.2 million for the same period in 2003. The increase was primarily attributable to the increase in sales of products with higher margin. Gross margin as a percent of revenue increased to 33% for the three months ended September 30, 2004 compared to 27% for same period in 2003. The increase in gross margin as a percentage of revenue was primarily attributable to higher sales volumes of our newer products, which yield higher margins in 2004 as compared to 2003, as described above.

Research and development expenses. Our research and development expenses for the three months ended September 30, 2004 increased $1.5 million, or 112%, to $2.9 million compared to $1.4 million for the same period in 2003. The increase was attributable to an increase of approximately $600,000 in salary and related expenses as a result of additional headcount during 2004 as compared to 2003, $600,000 in research supplies and expendable equipment, an increase of approximately $200,000 in outside consulting services and an increase of approximately $200,000 in travel and other miscellaneous costs. These increases were offset by decreases in depreciation, facility and overhead costs of approximately $200,000, primarily due to an increase in the number of assets that became fully depreciated during 2003 and the first half of 2004.

Sales and marketing expenses. Sales and marketing expenses for the three months ended September 30, 2004 increased $700,000, or 114%, to $1.3 million compared to $600,000 for the same period in 2003. The increase was primarily a result of an increase in sales and marketing efforts which included hiring new personnel during 2004. This effort resulted in an increase in salary and related expenses by approximately $400,000, an increase in outside consulting service and marketing costs of approximately $200,000 and an increase in travel costs of approximately $100,000.

General and administrative expenses. General and administrative expenses for the three months ended September 30, 2004 increased approximately $600,000, or 66%, to $1.4 million compared to $800,000 for the same period in 2003. The increase was primarily attributable to an increase in professional and consulting fees of approximately $400,000, primarily due to compliance obligations relating to Section 404 of the Sarbanes Oxley Act of 2002 and an increase in salary and related expenses of approximately $200,000 due to additional headcount during 2004 as compared to 2003.

Restructuring and impairment charges. Restructuring and impairment charges for the three months ended September 30, 2003 were $176,000 primarily comprised of severance payments and other related termination expenses associated with our restructuring plan. There were no restructuring and impairment charges included in the results for the three months ended September 30, 2004.

Amortization of deferred stock compensation. Amortization of deferred stock compensation for the three months ended September 30, 2004 decreased to $14,000 compared to $82,000 for the same period in 2003. This decrease was the result of our use of the attribution method of accounting to amortize deferred compensation associated with equity compensation awards in 2000 which results in the majority of this amortization being recognized in the earlier years following the equity grant.

Interest income and expense. Interest income increased by approximately $200,000 for the three months ended September 30, 2004 compared to the same period in 2003. The increase was due to the increase in the cash and marketable securities balances in 2004 as compared to the same period in 2003. Interest expense of $800,000 for the three months ended 2003 relates primarily to non-cash charges for the accretion of the imputed value assigned to the beneficial conversion feature on the Convertible Notes payable and interest charges on our bank line of credit.

Net income (loss). For the three months ended September 30, 2004, the Company reported net income applicable to common stockholders of $4.9 million as compared a net loss of $1.8 million for the same period in 2003.

Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003

Revenue. Revenue for the nine months ended September 30, 2004 increased $47.0 million, or 203%, to $70.3 million compared to $23.2 million for the same period in 2003. The overall increase in product sales of approximately $47.2 million was attributable primarily to higher sales volumes resulting from our introduction of new products and the increased demand for wireless products and wireless access services during 2004. Revenue recognized for development services decreased by $200,000 or 6% to $3.1 million during the first nine months of 2004 as compared to $3.3 million for the same period in 2003. 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 nine months ended September 30, 2004 increased $27.8 million, or 138%, to $47.9 million compared to $20.1 million for the same period in 2003. The increase in cost of revenue was attributable to a $24.1 million increase in product shipment costs, an increase in royalty costs of approximately $4.0 million, an increase in manufacturing overhead and warranty costs of approximately $1.4 million and an increase in amortization of software licenses of approximately $600,000. Costs of revenue for the nine months ended September 30, 2004 and 2003 includes an inventory charge of $100,000 and $2.0 million, respectively, for excess and obsolete inventory, primarily due to products that are no longer being manufactured. Cost of revenue related to products increased due to the increase in the demand for our products as described above. Total cost of revenue for development services during 2004 and 2003 amounted to $2.1 million and $2.5 million, respectively.

Gross margin. Gross margin for the nine months ended September 30, 2004 increased by $19.3 million to $22.4 million compared to $3.1 million for the same period in 2003. The increase was primarily attributable to the increase in sales of products with higher margin and an increase in margin on development services revenue discussed above. Gross margin as a percent of revenue increased to 31.8% for the nine months ended September 30, 2004 compared to 13.4% for same period in 2003. The increase in gross margin as a percentage of revenue was primarily attributable to sales of products with higher margin in 2004 as compared to 2003.

Research and development expenses. Our research and development expenses for the nine months ended September 30, 2004 increased $2.7 million, or 59%, to $7.3 million compared to $4.6 million for the same period in 2003. The increase primarily was attributable to an increase of approximately $1.4 million in research supplies and expendable equipment, $1.3 million was attributable to increases in salary and related expenses due to additional headcount during 2004 as compared to 2003 and an increase in outside consulting services and travel costs of approximately $800,000. These increases were offset by decreases in depreciation, facility and overhead costs of approximately $1.0 million, primarily due to an increase in the number of assets that became fully depreciated during 2003 and the first quarter of 2004.

Sales and marketing expenses. Sales and marketing expenses for the nine months ended September 30, 2004 increased $1.2 million, or 64%, to $3.1 million compared to $1.9 million for the same period in 2003. The increase was primarily a result of an increase in sales and marketing efforts, which included hiring new personnel during 2004, which increased salary and related expenses by approximately $800,000, an increase in travel costs of approximately $200,000 and an increase in outside consulting service and marketing costs of approximately $200,000.

General and administrative expenses. General and administrative expenses for the nine months ended September 30, 2004 increased approximately $800,000, or 25%, to $3.6 million compared to $2.8 million for the same period in 2003. The increase was primarily attributable to an increase in salary and related expenses of approximately $500,000 due to additional headcount during 2004 as compared to 2003, an increase in professional fees of approximately $500,000, offset by a decrease in depreciation costs of approximately $300,000 primarily due to an increase in the number of assets that became fully depreciated during 2003 and 2004.

Restructuring and impairment charges. Restructuring and impairment charges for the nine months ended September 30, 2003 were approximately $400,000 and were primarily comprised of severance payments and other related termination expenses associated with our restructuring plan. There was no charge included in the results for the nine months ended September 30, 2004.

Amortization of deferred stock compensation. Amortization of deferred stock compensation for the nine months ended September 30, 2004 decreased approximately $600,000, or 79%, to approximately $100,000 compared to approximately $700,000 for the same period in 2003. This decrease was the result of our use of the attribution method of accounting to amortize deferred compensation associated with equity compensation awards in 2000 which results in the majority of this amortization being recognized in the earlier years following the equity grant. The decrease also reflected a reduction in the unamortized portion of the deferred compensation attributable to previously awarded stock options cancelled during the second quarter of 2003, totaling $850,000.

Interest income and expense. Interest income increased by approximately $400,000 for the nine months ended September 30, 2004 compared to the same period in 2003. The increase was due to the increase in the cash and marketable securities balances in the first nine months of 2004 as compared to the same period in 2003. Interest expense of $2.5 million for the nine months ended 2003 relates primarily to non-cash charges of $2.3 million for the accretion of imputed value assigned to the beneficial conversion feature on the Convertible Notes payable and interest charges on our bank line of credit.

Net income (loss). For the nine months ended September 30, 2004, the Company reported net income applicable to common stockholders of $8.5 million as compared a net loss of $14.7 million for the same period in 2003.

Liquidity and Capital Resources

During the first quarter of 2004, we reached profitability for the first time since our inception and recorded net income applicable to common shareholders of $8.5 million for the nine months ended September 30, 2004. We had previously incurred significant costs to develop technologies and products, which exceeded total revenue. As a result, we had incurred losses in each year since inception through the end of 2003. As of September 30, 2004, we had an accumulated deficit of $238.6 million and working capital of $58.4 million.

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. Warrants to acquire 228,565 common shares at a price of $8.83, expiring on January 15, 2009, were also issued in conjunction with this offering.

Historical Cash Flows

Net cash provided by operating activities. Net cash provided by operating activities increased by $15.8 million to approximately $15.0 million for the nine months ended September 30, 2004 compared to net cash used in operating activities of approximately $800,000 for the same period in 2003. This increase was attributable to $8.7 million net income recorded for the nine months ended September 30, 2004 compared to a net loss of $9.8 million for the same period in 2003. The 2004 net income includes $2.6 million of depreciation and amortization expenses. The increase was also attributable to an increase in accrued expenses of $5.6 million and an increase in accounts payable of $3.9 million, offset by a decrease in our deferred revenue balance of $4.4 million and a $2.3 million increase in our inventory balance.

Net cash used in investing activities. Net cash used in investing activities for the nine months ended September 30, 2004 was approximately $53.0 million compared to $25,000 used in investing activities during the same period in 2003. The cash used in investing activities in 2004 was primarily due to the purchases of marketable securities of $50.0 million, purchases of intangibles of $1.5 million and purchases of property and equipment of $1.5 million. The cash used in investing activities in 2003 is primarily due to the purchases of intangible assets and property and equipment.

Net cash provided by financing activities. Net cash provided by financing activities for the nine months ended September 30, 2004 was $74.0 million, compared to $2.3 million during the same period in 2003. The cash provided from financing activities in 2004 was due to the net proceeds of $61.0 million received from a secondary offering equity transaction that was completed in May 2004, $7.5 million from the January 2004 issuance of common stock and proceeds from the exercise of common stock options and warrants of $5.9 million, offset by capital lease obligation payments of approximately $500,000. Cash provided by financing activities in 2003 was $2.3 million which was due to net proceeds of $2.7 million received from the issuance of Series B convertible preferred stock, $1.9 million of proceeds received on the issuance of convertible notes payable and proceeds from the exercise of common stock options and warrants, offset by repayments on our line of credit borrowings of $2.2 million and capital lease obligation payments of approximately $100,000.

Current Sources of Capital and Liquidity

As of September 30, 2004, we had working capital of $58.4 million, approximately $89.8 million in cash and cash equivalents and marketable securities.

Contractual Obligations and Commercial Commitments

The following table summarizes our contractual obligations and other commitments at September 30, 2004, and the effect such obligations could have on our liquidity and cash flow in future periods:

	Payments Due by Fiscal Year				
	2004	**2005**	**2006**	**2007**	**2008**
Capital lease and other obligations	$ 507,000	$1,127,000	$ —	$ —	$—
Operating leases	486,000	1,048,000	1,172,000	936,000	—
Committed purchase orders	42,217,000	—	—	—	—
Total contractual cash obligations	$43,210,000	$2,175,000	$1,172,000	$936,000	$—

Other Liquidity Needs

During the next twelve months we plan to incur approximately $3.0 million to $5.0 million for the acquisition of additional licenses and for capital expenditures. In addition, certain of our operating leases related to consolidated facilities obligate us to pay an aggregate of approximately $1.0 million, net of sublease income, over the next 36 months. This obligation is included in the operating lease commitment in the above table.

We believe that our available cash reserves together with our budgeted operating cash flows, 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 one of our significant sources of funds in the future will be our operating cash flow. Our future revenue is dependent on us fulfilling our commitments in accordance with agreements with a small number of major customers. Our liquidity could be impaired if there is any interruption to our business operations, a material failure to satisfy these contractual commitments or a failure to generate additional revenue from new or existing products.

Risks Related to Our Business

We have incurred significant operating losses since our inception and if we are unable to increase our revenue and gross margins, we may incur significant net losses and negative cash flow from operations.

We incurred significant operating losses and net losses in each annual period since our inception until the beginning of this fiscal year. In 2004, we reached profitability for the first time since its inception and recorded net income applicable to common stockholders of $8.5 million for the nine months ended September 30, 2004. In prior periods, we incurred net losses applicable to common shareholders of $16.7 million for the fiscal year ending 2003 and $53.5 million for the fiscal year ending 2002. In addition, we had positive cash flows from operations of $15.0 million for the nine months ended September 30, 2004, while we had negative cash flows from operations of $400,000 for the fiscal year ending 2003 and $28.7 million for the fiscal year ending 2002. As of September 30, 2004, we had an accumulated deficit of $238.6 million. If we are unable to continue increasing our revenue and gross margins sufficiently to offset our expenses, we may not maintain profitability and may incur operating losses, net losses and negative cash flow from operations.

If we experience negative cash flow from operations, we may need to raise additional capital to fund our working capital requirements and anticipated capital expenditures.

We have experienced negative cash flow from operations in the past and, excluding working capital requirements to fund our growth, have only recently become cash flow positive. We currently anticipate that budgeted cash flow from operations, together with our current working capital, will be sufficient to meet our working capital requirements and anticipated capital expenditures for the next twelve months. However, the forecast of our ability to meet working capital requirements and anticipated capital expenditures in the future is a forward-looking statement that involves risks and uncertainties and actual results could vary. Our budgeted cash flow from operations includes assumptions about increased sales volumes. If we are unable to increase our revenue and gross margins sufficiently to offset our operating expenses, we will again experience negative cash flow from operations and may be required to raise additional capital. Our ability to obtain additional capital will depend on financial market conditions, investor expectations for the wireless technology industry, the national economy and other factors outside our control. If we issue equity securities, our stockholders will experience dilution. There can be no assurance that any such additional financing will be available on acceptable terms, or at all. If needed, the failure to secure additional financing would have a material adverse effect on our business, financial condition and operating results.

Our failure to predict and comply with evolving 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 standards and that our products comply with such standards. We are currently focused on manufacturing and engineering products that comply with 3G wireless standards. Any failure of our products to comply with 3G or future standards could delay their introduction and require costly and time-consuming engineering changes. Additionally, if wireless operators or subscribers fail to adopt the standards to which we engineer our products, then sales of our new products could be materially harmed.

If we fail to develop and introduce new products successfully, we may lose key customers or product orders and may not be able to compete effectively.

The development of new 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 standards, which may differ from the standards of other operators. If we fail to complete the development of products on time and within budgeted amounts, we will be unable to introduce new products into the market on a timely basis, if at all. In addition, as we introduce new versions of our existing products or new products altogether, our current customers may not require the technological innovations of these products and may not purchase them.

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

- We have priced these contracts based on our estimated production costs. If our actual production costs are higher than our estimated costs, our gross margins on the corresponding contracts will decrease.
- If we are unable to commit the necessary 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 product we delivered does not meet the agreed-upon specifications, we may have to reduce the price we can charge for such product, or we may be required to pay damages to the customer.

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

The wireless communications market is highly competitive, and we may be unable to compete effectively.

The markets for wireless data access products are highly competitive, and we expect competition to increase. Many of our competitors or potential competitors have significantly greater financial, technical and marketing resources than we do. These competitors may be able to respond more rapidly than we can to new or emerging technologies or changes in customer requirements. They also may devote greater resources than we do to the development, promotion and sale of their respective products.

Many of our current or potential competitors have more extensive customer bases and broader customer relationships and industry relationships that they can leverage to establish relationships with many of our current and potential customers. These companies also have more established customer support and professional services organizations. In addition, these companies may adopt aggressive pricing policies or offer more attractive terms to customers, may bundle their competitive products with broader product offerings and may introduce new products and enhancements. Current and potential competitors may establish cooperative relationships among themselves or with third parties to enhance their products. As a result, it is possible that new competitors or relationships among competitors may emerge and rapidly acquire significant market share.

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

- wireless data modem providers, such as Kyocera, Option International, Sierra Wireless, Sony-Ericsson and Wavecom;
- wireless device manufacturers, such as palmOne and Research in Motion; and
- wireless handset manufacturers, such as Motorola, Nokia, Samsung and Sony-Ericsson.

We expect our competitors to continue to improve the performance of their current products and to introduce new products, services and technologies. For instance, new models of laptop PCs and handheld computing devices could include internal wireless modems installed by the manufacturer which would reduce the need for consumers to purchase our aftermarket wireless modem products. 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 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 to remain competitive. Increased competition could result in price reductions, fewer 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.

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 maintain these relationships and to cultivate additional or alternative relationships. We cannot assure you 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.

We depend upon a small number of our customers for a substantial portion of our revenue and we currently rely upon a few of our key customers to make contractual minimum volume purchases.

A significant portion of our revenue comes from a small number of customers. Our top ten customers for the nine months ended September 30, 2004 and 2003 accounted for approximately 70.0% and 97.8% of our revenue, respectively. Our top ten customers for fiscal 2003 and 2002 accounted for approximately 94.7% and 84.6% of our revenue, respectively. Similarly, our revenue could be adversely affected if we are unable to retain the business of any of our significant customers or if we are unable to diversify our customer base.

Some of our key customers are currently obligated to make minimum volume purchases pursuant to contracts. Following the expiration of such obligations, those customers will not be obligated to make any purchases of our products. In addition, a majority of our customers purchase our products under purchase orders and not pursuant to any contractual minimum purchase obligations. Such customers have no contractual obligation to purchase our products and if they do not continue to make purchases, 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 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 anticipated and our product sales did not generate sufficient revenue to cover our operating costs. The failure of these markets to continue to grow may adversely impact 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 on the capacity, affordability and reliability of wireless data networks provided by various wireless telecommunications operators. Currently, various wireless telecommunications operators, either directly 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 wireless telecommunications operators cease 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 occurs, 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 disruptions in our business.

Various risks arise when companies and industries grow quickly. If our business grows, our ability to meet customer demand in a timely and efficient manner could be challenged. We may also experience production delays as we seek to meet increased demand for our products. Our failure to manage our growth 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 customers.

We have depended on a single third-party manufacturer to produce all of our products which subjects us to potential disruptions in product supply and other potential adverse effects.

Since September, 2002, we have outsourced the manufacturing of all of our products to LG Innotek. In August 2004, we entered into an agreement with Celestica Corporation (Celestica) pursuant to which Celestica will manufacture certain products for us in China which we expect will commence in November 2004. We will continue to manufacture some of our products at LG Innotek. We expect to continue to depend on LG Innotek and Celestica or other third-party manufacturers to produce our products in a timely fashion and at satisfactory quality levels. LG Innotek and Celestica are not obligated to supply products to us for any specific quantity, except as may be provided in particular purchase orders which we submit to them from time to time and therefore could cease or reduce its business with us at its discretion. If either or both LG Innotek or Celestica experience delays, disruptions, capacity constraints or quality control problems in their manufacturing operations, product shipments to our customers could be delayed, which would negatively impact our revenues and our competitive position and reputation. Further, if we are unable to manage successfully our relationship with LG Innotek and/or Celestica, the quality and availability of our products may be harmed. If LG Innotek and /or Celestica stopped manufacturing our products for any reason or reduced their 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 LG Innotek and/or Celestica negatively change the payment and other terms under which they agree 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 components.

We generally place orders with our manufacturers at least three months prior to scheduled delivery of products to our customers. Accordingly, if we inaccurately anticipate demand for our products, we may be unable to obtain adequate quantities of components to meet our customers' delivery requirements or, alternatively, we may accumulate excess inventories. If one or more of these events were to occur, we could experience increased costs, reduced revenue and lower product margins.

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 depend on sole source suppliers for some of our components, and our product availability and sales would be harmed if any of these suppliers are not able to meet our demand and alternative 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. If there is a shortage of any such components, we may not be able to deliver sufficient quantities of our products to satisfy demand. The cost, quality and availability of components are essential to the successful production and sale of our products. Some of these components come from sole or single source suppliers for which alternative components may not be available. If suppliers are unable to meet our demand for sole source components and if we are unable to obtain an alternative source or if the price for a substitute is prohibitive, our ability to maintain timely and cost-effective production of our products would be seriously harmed.

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

From time to time, we may be required to license technology from third parties to develop new products or product enhancements. We have licensed software for use in our products from third-parties, such as 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. We cannot assure you 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 any third-party license required to develop new products and product enhancements could require us to obtain substitute technology of lower quality or performance standards 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 operations and sales and our ability to obtain products from foreign manufacturers.

Since September, 2002, we have outsourced the manufacturing of all of our products to LG Innotek. In August 2004, we entered into an agreement with Celestica Corporation pursuant (Celestica) to which Celestica will manufacture certain products for us in China which we expect will commence in November 2004. We will continue to manufacture some of our products at LG Innotek. In addition, we have international operations and sales, and a significant portion of our research and development staff is located in Canada. Our international sales accounted for approximately 74.6% of our revenue for the nine months ended September 30, 2004 and 7.3% for fiscal 2003. 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:

- changes in international currency exchange rates;
- 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 international 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;
- international dock strikes or other transportation delays; and
- difficulty in managing widespread sales and research and development operations.

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.

Our products may contain errors or defects, which could decrease their market acceptance.

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, damage to our reputation, lost revenue, diverted development resources, and increased customer service and support costs and warranty claims.

We may not be able to adequately protect our intellectual property, and we could incur substantial costs defending our intellectual property from infringement or a claim of infringement.

Our success depends in part on our proprietary technology. We rely on a combination of patents, copyrights, trademarks and trade secrets, confidentiality provisions and licensing arrangements to establish and protect our proprietary rights. We may be required to spend significant resources to monitor and police our intellectual property rights. Despite these expenditures, we may not be able to detect infringement and as a consequence we may lose our competitive position in the market. Intellectual property rights also may be unavailable or limited in some foreign countries, which could make it easier for competitors to capture market share in such countries. The unauthorized use of our technology by competitors could have a material adverse effect on our ability to sell our products in some markets.

Although we are not currently involved in any material intellectual property litigation, we may be a party to material litigation in the future either to protect our intellectual property or as a result of an alleged infringement of others' intellectual property. These claims and any resulting litigation could subject us to significant liability for damages or could cause our proprietary rights to be invalidated. Litigation, regardless of the merits of the claim or outcome, would likely be time-consuming and expensive to resolve and would divert management time and attention away from the operation of our business. Any potential intellectual property litigation against us could also force us to do one or more of the following:

- stop using the challenged intellectual property and refrain from selling our products or services that incorporate it;
- obtain a license to use the challenged intellectual property or to sell products or services that incorporate it, which license may not be available on reasonable terms, or at all; or

- redesign those products or services that are based on or incorporate the challenged intellectual property.

If we are forced to take any of the foregoing actions, we may be unable to manufacture and sell our products, or we may be unable to do so on terms economically favorable to us, and our business, financial condition and results of operations may be materially adversely affected.

Our quarterly operating results may fluctuate in the future and may cause our stock price to decline.

Our future quarterly operating results may fluctuate significantly and may not meet the expectations of securities analysts or investors. If this occurs, the market price of our stock would likely decline. The following factors 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 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 a contract may take several months, and is subject to delays over which we have little or no control. The sale of our products is subject to delays from our customers' budgeting, approval, testing 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.

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 performance.

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 regulates many aspects of communications devices, including radiation of electromagnetic energy, biological safety and rules for devices to be connected to telephone networks. 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 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.

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. In particular, the services of Peter Leparulo, our Chief Executive Officer, would be difficult to replace. 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 are bound by employment agreements. 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 intend to review, on an ongoing basis, acquisition opportunities that we believe would be advantageous 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 and results of operations:

- issue equity 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 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.

In the event we are unable to satisfy regulatory requirements relating to internal controls, or if these internal controls over financial reporting are not effective, our business could suffer.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we will be required during 2004 to perform an evaluation of our internal controls over financial reporting and have our auditor attest to such evaluation. We have prepared an internal plan of action for compliance, including a timeline and scheduled activities, although as of the date of this filing we have not yet completed the evaluation. Our auditors have not yet completed their testing of our internal controls. Compliance with these requirements has been and continues to be expensive and time consuming. If we fail to timely complete this evaluation, or if our auditors cannot timely attest to our evaluation, we could be subject to regulatory scrutiny and a loss of public confidence in our internal controls.

In designing and evaluating our internal controls over financial reporting, we recognize that any internal control or procedure, no matter how well designed and operated, can provide only reasonable assurance of achieving desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. While we believe that our internal controls over financial reporting currently provide reasonable assurance of achieving their control objectives, no system of internal controls can be designed to provide absolute assurance of effectiveness. See "Item 4. Controls and Procedures" contained in this report. A material failure of internal controls over financial reporting could materially impact our reported financial results and the market price of our stock could significantly decline. Additionally, adverse publicity related to a material failure of internal controls over financial reporting could have a negative impact on our reputation and business.

To the extent we enter into contracts that are denominated in foreign currencies, fluctuations in exchange rates between the United States dollar and other foreign currencies may affect our operating results.

Our distribution agreements in Europe and the Asia-Pacific region have been previously denominated solely in U.S. dollars. Recently, we have entered into sales agreements denominated in foreign currencies and expect to enter into additional agreements as we expand our international customer base. We cannot assure you that we will not incur foreign currency losses or that any hedging activities we may enter into to reduce the risk of such losses will be successful.

If we are required to account for stock options under our employee stock plans as a compensation expense, our net income and earnings per share would be significantly reduced.

We record compensation expense only in conjunction with option grants to non-employees. For employee option grants, we calculate compensation expense and disclose the impact on net income (loss) and net income (loss) per share in a footnote to our financial statements. It is likely that future accounting pronouncements will require us to record compensation expense for employee stock option grants in our statement of operations. Note 1, “Stock Based Compensation,” of our financial statements reflects the impact that such a change in accounting treatment would have had on our net income (loss) and net income (loss) per share if it had been in effect during the past three years.

Utilization of our net operating loss carryforwards is dependent on future taxable income and may be limited in certain events.

Through December 31, 2003, we generated approximately $143.3 million in net operating losses carryforwards for federal income tax purposes. Generally, these net operating loss carryforwards may be used to offset taxable income in future periods, but are limited in that they are available for a maximum of 20 years, as specified in Section 382 of the Internal Revenue Code of 1986, as amended (the “Code”). In addition, the availability of tax loss carryforwards may be limited both in the aggregate and on an annual basis in the event of an ownership change (as defined in the Code). During the year ended December 31, 2003, we completed a series of equity transactions, including the issuance of our Series B Convertible Preferred Stock. We are currently analyzing and evaluating those equity issuances and related transactions in the context of Section 382 of the Code to determine what impact, if any, they may have had on our future utilization of our net operating loss carryforwards. Though we have not yet completed our analysis, we do not believe that the limitations, if any, would impair our ability to use our net operating loss carryforwards to fully offset taxable income for the year ending December 31, 2004.

For financial reporting purposes, net operating loss carryforwards are reflected as a deferred tax asset on a company’s balance sheet in an amount equal to the estimated income taxes attributable to future taxable income available for offset, net of any valuation allowances established to reflect the possibility of less than full utilization of the deferred tax asset. At September 30, 2004, we had established a valuation allowance equal to the full amount of the deferred tax asset attributable to our net operating loss carryforwards. In calculating our tax provision for future periods, we will continue to assess the likelihood that we will be able to use the deferred tax assets, taking into consideration forecasted book and taxable income and potential limits resulting from ownership changes and other events, if any, and will adjust the valuation allowance on the deferred tax assets as appropriate. The tax benefit recognized upon the reversal of all or part of the valuation allowance may distort the trends in our net income after taxes relative to taxable income, and, accordingly, would impact the comparability of our results with other periods. This may make our financial results appear more favorable than those of companies with similar operations and without the availability of net operating loss carryforwards or other deferred tax assets.

Others could claim that we infringe on their intellectual property rights, which may result in substantial costs, diversion of resources and management attention and harm to our reputation.

It is possible that other parties may claim that we have violated their intellectual property rights. An infringement claim could result in substantial costs, diversion of resources and management attention and harm of our reputation. Rights to intellectual property can be difficult to verify. A successful infringement claim against us could cause us to be liable for damages and litigation costs. We may also be prohibited from further use of the intellectual property. We may have to license the intellectual property, incurring licensing fees, or we may have to develop a non-infringing alternative, which could be costly and delay sales of our products or loose sales of our products.

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

Interest Rates. Our investment portfolio is maintained in accordance with our investment policy that defines allowable investments, specifies credit quality standards and limits the credit exposure of 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 September 30, 2004, we had $89.8 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 $40.0 million of our cash and cash equivalents at September 30, 2004, 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 $48.9 million of our investments by approximately $0.4 million. 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 a permanent impairment.

Foreign Currency Transactions. During the nine months ended September 30, 2004, we had a foreign currency loss of approximately $33,000 recorded in other income and expenses related to our restructuring accrual denominated in Canadian dollars. Revenues generated outside the United States (denominated in U.S. dollars), as a percentage of total revenues were 74.6% for the nine months ended September 30, 2004 and 11.6% for the same period in 2003. Fluctuations in foreign exchange rates could impact future operating results

Subsequent to September 30, 2004, we entered into sales transactions denominated in Euros. In order to hedge against the short-term impact of foreign currency fluctuations on our receivable balances we have entered into a forward foreign exchange contract. 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 this financial instrument does 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 September 30, 2004, our financial position, results of operations and cash flows would not be materially affected.

Item 4. *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 and principal accounting officer, 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 September 30, 2004, 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 chief executive officer and principal accounting officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our chief executive officer and principal accounting officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Controls: There have been no significant changes in our internal control over financial reporting or identified in connection with the evaluation referenced above that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. ***Legal Proceedings***

None

Item 6. ***Exhibits and Reports on Form 8-K***

(a) Exhibits

Exhibit Number	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

Current reports on Form 8-K, furnished October 28, 2004.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 12, 2004

Novatel Wireless, Inc.

By: /s/ Dan L. HALVORSON

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

Section 302 Certifications

CERTIFICATIONS

Each of the undersigned, in his capacity as the Chief Executive Officer and Chief Financial Officer of Novatel Wireless Inc., as the case may be, provides the following certifications required by 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of The Sarbanes-Oxley Act of 2002, and 17 C.F.R. § 240.13a-14.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Peter Leparulo, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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(s) 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)) 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) 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

(c) 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 third fiscal quarter in the case of this 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(s) 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/ Peter Leparulo

Peter Leparulo
Chief Executive Officer

Dated: November 12, 2004

Exhibit 31.2

CERTIFICATION OF THE CHIEF FINANCIAL OFFICER

I, Dan L. Halvorson, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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(s) 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)) 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) 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

(c) 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 third fiscal quarter in the case of this 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(s) 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

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

Dated: November 12, 2004

Exhibit 32

CERTIFICATIONS

Each of the undersigned, in his capacity as the Chief Executive Officer and Chief Financial Officer of Novatel Wireless, Inc., as the case may be, provides the following certifications required by 18 U.S.C. Section 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002:

1. This Report on Form 10-Q fully complies with the requirements of Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

IN WITNESS WHEREOF, the undersigned have set their hands hereto as of the 12th day of November, 2004.

/s/ Peter Leparulo

Peter Leparulo
Chief Executive Officer

/s/ Dan L. Halvorson

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