

INSIGNIA SOLUTIONS PLC
Form 10-Q
May 16, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2003

or,

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

For the transition period from _____ to _____

Commission file number 0-27012

Insignia Solutions plc

(Exact name of Registrant as specified in its charter)

England and Wales

(State or other jurisdiction
of incorporation or
organization)

**41300 Christy Street
Fremont
California 94538
United States of America
(510) 360-3700**

Not applicable

(I.R.S. employer
identification number)

**Mercury Park, Wycombe Lane
Wooburn Green
High Wycombe, Bucks HP10 0HH
United Kingdom
(44 1628-539500)**

(Address and telephone number of principal executive offices and principal places of business)

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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

As of May 5, 2003, there were 20,088,709 ordinary shares of £0.20 each nominal value, outstanding.

INSIGNIA SOLUTIONS PLC

PART 1 FINANCIAL INFORMATION

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

INSIGNIA SOLUTIONS PLC

CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, unaudited)

	March 31, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 124	\$ 726
Restricted cash	90	250
Accounts receivable, net of allowances of \$28 and \$50, respectively	397	931
Tax receivable	706	702
Prepaid royalties	901	1,000
Prepaid expenses	478	695
Other current assets	441	438
Total current assets	3,137	4,742
Property and equipment, net	186	230
Prepaid royalties	1,381	1,381
Other non-current assets		100
	\$ 4,704	\$ 6,453
LIABILITIES, MANDATORILY REDEEMABLE WARRANTS AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,124	\$ 665
Accrued liabilities	818	950
Accrued severance	209	
Note payable	1,000	
Deferred revenue	451	534
Income taxes payable	187	191
Total current liabilities	3,789	2,340
Commitments and Contingencies (Note 6)		
Mandatorily redeemable warrants	1,440	1,440
Shareholders' equity:		
Ordinary shares	6,445	6,444
Additional paid-in capital	59,901	59,901
Accumulated deficit	(66,410)	(63,211)
Other accumulated comprehensive loss	(461)	(461)
Total shareholders' equity	(525)	2,673
	\$ 4,854	\$ 6,453

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

INSIGNIA SOLUTIONS PLC

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(amounts in thousands, except per share amounts, unaudited)

	Three months ended March 31,	
	2003	2002
Net revenues:		
License	\$ 192	\$ 2,988
Service	187	556
Total net revenues	379	3,544
Cost of net revenues:		
License	115	1,014
Service	52	197
Total cost of net revenues	167	1,211
Gross margin	212	2,333
Operating expenses:		
Sales and marketing	645	1,721
Research and development	1,306	1,196
General and administrative	1,144	938
Restructuring	326	
Total operating expenses	3,421	3,855
Operating loss	(3,209)	(1,522)
Interest income (expense), net	(1)	21
Other income (expense), net	13	(32)
Loss before income taxes	(3,197)	(1,533)
Provision (benefit) for income taxes	2	(561)
Net loss	\$ (3,199)	\$ (972)
Basic and diluted net loss per share	\$ (0.16)	\$ (0.05)
Weighted average shares and share equivalents:		
Basic and diluted	20,089	19,574

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

INSIGNIA SOLUTIONS PLC
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands, unaudited)

	Three months ended March 31,	
	2003	2002
Cash flows from operating activities:		
Net loss	\$ (3,199)	\$ (972)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	45	67
Allowance for doubtful accounts	(22)	(15)
Net changes in assets and liabilities:		
Accounts receivable	556	1,446
Tax receivable	(4)	
Prepaid royalties	99	(741)
Prepaid expenses	217	4
Other current assets	(3)	
Other noncurrent assets	100	
Accounts payable	459	7
Accrued liabilities	(132)	(15)
Accrued severance	209	
Deferred revenue	(83)	(2,360)
Income taxes payable	(4)	(2)
Net cash used in operating activities	(1,762)	(2,581)
Cash flows from investing activities:		
Purchases of property and equipment	(1)	
Proceeds from sale of property and equipment		(21)
Proceeds from release of restricted cash	160	
Proceeds from note payable	1,000	
Net cash provided by (used in) investing activities	1,159	(21)
Cash flows from financing activities:		
Proceeds from issuance of shares, net		(1)
Proceeds from exercise of warrants		481
Proceeds from exercise of stock options	1	61
Net cash provided by financing activities	1	541
Net decrease in cash and cash equivalents	(602)	(2,061)
Cash and cash equivalents at beginning of the period	726	8,643
Cash and cash equivalents at end of the period	\$ 124	\$ 6,582

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

INSIGNIA SOLUTIONS PLC

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

(unaudited)

Note 1. Basis of presentation

The accompanying condensed consolidated financial statements and related notes include the accounts of Insignia Solutions plc (Insignia , us or we) and its wholly owned subsidiaries and are unaudited. However, in the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary for a fair presentation of the financial position and results for the interim period have been included. Interim results are not necessarily indicative of results for a full year.

During the past 24 months, we have incurred an aggregate loss from operations and negative operating cash flows of \$21,230,000 and \$19,156,000, respectively. We have undertaken measures to reduce operating expenses and redesign our commercial efforts to adapt to new developments. As part of these new developments, our current plans may require obtaining additional financing within the next 12 months. If such financing is not obtained, or if we experience a significant shortfall in expected revenue, we will need to further reduce the level of expenses in order to meet our working capital requirements during the next 12 months.

Assuming the receipt of the \$6.9 million due from esmertec A.G. (esmertec) under the Asset Purchase Agreement and the Master Distribution and License Agreement, each dated March 4, 2003, and the definitive agreements signed on April 23, 2003 (see Note 5), and assuming that management achieves its plans to generate SSP revenue in the second half of the year while controlling operating costs, we believe that Insignia will have sufficient funds to meet its operating and capital requirements through the end of fiscal year 2003. However, there can be no assurance that we will not require additional funding or that we will be able to obtain additional funding if needed, on acceptable terms or at all. The failure to raise additional funds, if needed, on a timely basis and on sufficient favorable terms could have a material adverse effect on our business, operating results and financial condition. Insignia s liquidity may also be adversely affected in the future by factors such as continued higher interest rates, inability to borrow without collateral, availability of capital financing and continued operating losses. In addition, as of March 31, 2003, we were not in compliance with the minimum stock price and total shareholders equity requirements to maintain the listing of our ADSs on the Nasdaq SmallCap Market. These circumstances raise substantial doubt about Insignia s ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We follow accounting policies that are in accordance with principles generally accepted in the United States of America. We conduct most of our business in U.S. dollars. All amounts included in the financial statements and in the notes herein are in U.S. dollars unless designated £ , in which case they are in British pound sterling. The exchange rates used between the U.S. dollar and the British pound sterling were \$1.58 and \$1.43 (expressed in U.S. dollars per British pound sterling) at March 31, 2003 and 2002, respectively.

The results of operations for the three months ended March 31, 2003 are not necessarily indicative of the results to be expected for the entire fiscal year, which ends on December 31, 2003.

These unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2002, included in Insignia's 2002 Annual Report and Form 10-K.

Note 2. Net income (loss) per share

Net income (loss) per share is presented on a basic and diluted basis, and is computed using the weighted average number of ordinary shares and ordinary equivalent shares outstanding during the period. Ordinary equivalent shares consist of warrants and stock options (using the treasury stock method). Under the basic method of calculating net income (loss) per share, ordinary equivalent shares are excluded from the computation. Under the diluted method of calculating net income (loss) per share, ordinary equivalent shares are excluded from the computation if their effect is antidilutive.

Statement regarding computation of loss per share (in thousands except per share data):

	Three months ended March 31,	
	2003	2002
Net loss	\$ (3,199)	\$ (972)
<u>Calculation of basic and diluted loss per share:</u>		
Weighted average number of ordinary shares outstanding used in computation	20,089	19,574
Basic and diluted loss per share	\$ (0.16)	\$ (0.05)

If Insignia had reported net income, the following weighted average number of options and warrants would not be included in the calculation of diluted EPS because their inclusion would have been anti-dilutive:

	Three months ended March 31,	
	2003	2002
Options	3,308,179	69,739
Warrants	4,191,334	189,653

Note 3. Comprehensive income (loss)

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Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (SFAS 130), requires that all items recognized under accounting standards as components of comprehensive earnings be reported in an annual statement that is displayed with the same prominence as other annual financial statements. SFAS 130 also requires that an entity classify items of other comprehensive earnings by their nature in an annual financial statement. Comprehensive income, as defined, includes all changes in equity during a period from non-owner sources.

Note 4. Stock based compensation

On December 31, 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 148 (SFAS No. 148), Accounting for Stock Based Compensation-Transition and Disclosure , which amends SFAS No. 123. SFAS No. 148 requires more prominent and frequent disclosures about the effects of stock-based compensation, which we have adopted for the year ended December 31, 2002. We account for our employee stock option plans and employee stock purchase plan in accordance with provisions of the Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and FASB Interpretation No. 44 (FIN 44), Accounting for Certain Transactions Involving Stock Compensation an Interpretation of APB No. 25, and complies with the disclosure provision of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (FAS 123) in these notes to consolidated financial statements. Under APB No. 25, compensation costs is determined based on the difference, if any, on the grant date between the fair value of our stock and the amount an employee must pay to acquire the stock.

Stocks, stock options, and warrants for stock issued to non-employees have been accounted for in accordance with the provisions of SFAS 123 and Emerging Issue Task Force Issue No. 96-18, (EITF 96-18) Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services .

Fair value disclosures

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Had the compensation cost for our stock option plans and the Purchase Plan been determined based on the fair value at the grant dates, as prescribed in FAS 123, the net income (loss) and net income (loss) per share would have been adjusted to the pro-forma amounts indicated below (in thousands, except per share data):

	Three months ended March 31,	
	2003	2002
Net loss-as reported	\$ (3,199)	\$ (972)
Less stock based compensation expense determined under fair value based method	(1,926)	(2,417)
Pro forma Net loss-pro forma	(5,125)	(3,389)
Net loss per share-basic as reported	(0.15)	(0.05)
Net loss per share-basic Pro forma	(0.25)	(0.17)
Net loss per share-diluted as reported	(0.15)	(0.05)
Net loss per share-diluted pro forma	\$ (0.25)	\$ (0.17)

In accordance with the disclosure provisions of FAS 123, the fair value of employee stock options granted the three months ended March 31, 2003 and 2002 was estimated at the date of grant using the Black-Scholes model and the following weighted average assumptions:

	Three months ended March 31,	
	2003	2002
Stock Options:		
Volatility range	59%	71%
Risk-free interest rate range	1.0 - 3.1%	1.8 - 4.2%
Dividend yield	0%	0%
Expected life (years)	4	4
Employee Stock Purchase Plan:		
Volatility range	59%	71%
Risk-free interest rate range	1.2%	1.7%
Dividend yield	0%	0%
Expected life (years)	.5	.5

Total comprehensive loss was not different from the net loss reported for the three months ended March 31, 2003.

Note 5. New accounting pronouncements

In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No., Accounting for Exit or Disposal Activities (SFAS 146). SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for under the Emerging Issues Task Force (EITF) No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The scope of SFAS 146 also includes costs related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The provisions of EITF No. 94-3 shall continue to apply for an exit activity initiated under an exit plan that meets the criteria of EITF No. 94-3 prior to the adoption of SFAS 146. The effect on adoption of SFAS 146 will change on a prospective basis the timing of when restructuring charges are recorded from a commitment date approach to when the liability is incurred. SFAS 146 was adopted in the first quarter of 2003. The adoption of SFAS 146 did not have a material effect on our financial position, results of operations, or cash flows.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 . FIN 46 requires certain variable interest entities to 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. FIN 46 is effective immediately for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. We adopted FIN 46 effective February 1, 2003. The adoption of FIN 46 did not have a material impact on our financial position, results of operation or cash flows.

Note 6. Esmertec Agreements

On February 7, 2003, we entered into a loan agreement with esmertec whereby esmertec loaned Insignia \$1 million. The loan was made in two installments of \$500,000 each on February 13, 2003 and February 26, 2003. The rate of interest on each loan is at prime plus two percent. Accrued interest is due on the last day of each month. The accrued interest as of March 31, 2003 was \$6,730. The principal and any outstanding accrued interest is due on or before February 3, 2004.

On March 4, 2003, we entered into several other agreements (the Agreements) with esmertec including a definitive agreement to sell certain assets relating to our Java Virtual Machine (JVM) line of business in exchange for \$3.5 million payable in installments. Payments under the agreement would be \$800,000 on April 18, 2003, \$800,000 on July 23, 2003, \$800,000 on October 15, 2003, \$800,000 on January 15, 2004 and \$300,000 on April 15, 2004. The assets primarily included the fixed assets, customer agreements and employees related to the JVM line

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of business. The transaction closed on April 23, 2003. Under the terms of the Agreements, esmertec became the exclusive master distributor of the JVM technology in exchange for \$3.4 million in minimum guaranteed royalties through June 30, 2004 at which time, the JVM technology rights will transfer to esmertec. Minimum payments under the license are as follows:

DUE DATE	PAYMENT
April 30, 2003	\$ 250,000
May 15, 2003	\$ 200,000
July 15, 2003	\$ 200,000
July 31, 2003	\$ 250,000
August 15, 2003	\$ 200,000
October 15, 2003	\$ 200,000
October 31, 2003	\$ 250,000
November 15, 2003	\$ 200,000
January 15, 2004	\$ 200,000
January 31, 2004	\$ 250,000
February 15, 2004	\$ 200,000
April 15, 2004	\$ 200,000
May 15, 2004	\$ 200,000
July 15, 2004	\$ 200,000
August 15, 2004	\$ 200,000
October 15, 2004	\$ 200,000
Total	\$ 3,400,000

In addition, we can earn up to an additional \$4.0 million over the next three years based on a percentage of esmertec's future sales of the JVM product. Additionally, the parties have entered into a cooperative agreement to promote Insignia's Secure System Provisioning (SSP) software product to esmertec's mobile platform customers. The Agreements provide for esmertec to manage the existing Insignia JVM customer relationships and license the Insignia and esmertec technologies to sell to the then combined customer base and business partners. Under the Agreements, esmertec will assume the entire JVM business through a final asset purchase in June 2004.

As part of the sale of our JVM business, we transferred 42 employees to esmertec, of which 31 were development engineers. In addition, as part of the sale, esmertec entered into an agreement with our U.K. building landlord to assume the lease on one of the two buildings leased by Insignia.

The Jeode platform had been our principal product line since the third quarter of 1999. With the completion of the sale of our JVM business to esmertec in April 2003, Insignia's sole product line will consist of its SSP products for the mobile handset and wireless carrier industry. The SSP product became available for lab and market trials in early 2003 and is expected to be available for shipment to customers in the second half of 2003.

On February 11, 2003, we announced a restructuring of the organization to focus on the SSP technology. As part of the restructuring, Richard Noling resigned as Chief Executive Officer and Acting Chief Financial Officer. Mark McMillan, President and Chief Operating Officer, was promoted to Chief Executive Officer and Linda Potts, Controller, was promoted to Chief Financial Officer.

In September 2001, Insignia and Sun Microsystems, Inc. (Sun) entered into Amendment No. 3 (the Amendment) to the Technology License and Distribution Agreement (the Distribution Agreement) between the two companies. In addition, in June 2001, the two companies entered into an addendum (the Addendum) to the Distribution Agreement relating to distribution of products to an Insignia customer. The Amendment and the Addendum each require Insignia to make non-refundable royalty prepayments to Sun. A total of \$7.0 million of prepaid royalties were paid to Sun under these agreements through the third quarter of 2002. There are no additional royalty prepayments due to Sun under this agreement. The amended Distribution Agreement expires June 30, 2004. Any unused royalty prepayments outstanding on June 30, 2004 are forfeited. The prepaid royalty balance as of March 31, 2003 was \$2.3 million.

During 1998, Insignia sublet until March 2002 facilities it previously occupied in the United Kingdom, on substantially the same terms as those applicable to Insignia. In January 2002, Insignia entered into an agreement with the landlord to terminate the lease on April 3, 2002 and paid a surrender payment of approximately \$470,000.

Note 7. Commitments and Contingencies

Guarantee Agreements

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Guarantees of Indebtedness of Others. FIN 45 requires that upon issuance of certain guarantees, a guarantor must recognize a liability for the fair value of an obligation assumed under the guarantee. FIN 45 also requires significant new disclosures, in both interim and annual financial statements by a guarantor about obligations associated with guarantees issued.

Insignia, as permitted under Delaware law and in accordance with our Bylaws, indemnifies our officers and directors for certain events or occurrences, subject to certain limits, while the officer is or was serving at our request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum amount of potential future indemnification is unlimited; however we do have a Director and Officer Insurance Policy that limits our exposure and enables us to recover a portion of any future amounts paid. As a result of the insurance policy coverage we believe the fair value of these indemnification agreements is minimal.

In our sales agreements, we typically agree to indemnify our customers for any expenses or liability resulting from claimed infringements of patents, trademarks or copyrights of third parties for the products, as delivered by Insignia. The terms of these indemnification agreements are generally perpetual any time after execution of the agreement. The maximum amount of potential future indemnification is unlimited, however, we normally retain the right to limit the remedies the customer may receive. We have not paid any amounts to settle claims or defend lawsuits.

Insignia, on a limited basis, has granted price protection. The terms of these agreements are generally perpetual. We have not recorded any liabilities for these potential future payments either because they are not probable or we have yet to incur the expense.

Insignia warrants the binary version of its software products against defects in material and workmanship under normal use and service for a period of ninety days. All warranties are

disclaimed for source code licenses. There is no warranty accrual recorded because potential future payments either are not probable or we have yet to incur the expense.

Note 8. Segment reporting

Statement of Financial Accounting Standards 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131), provides for segment reporting based upon the management approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of Insignia s reportable segments. SFAS 131 also requires disclosures about products and services, geographic areas, and major customers.

We operate in a single industry segment providing virtual machine technology which enables software applications and operating systems to be run on various computer platforms. In the first quarter of 2003, Hewlett-Packard Company accounted for 34% of total revenues. In the first quarter of 2002, Phoenix Technologies, Ltd. (Phoenix), accounted for 78% of total revenues. No other customer accounted for 10% or more of Insignia s total revenues during the first quarter of 2003 and 2002.

Geographic information

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Financial information by geographical region is summarized below (in thousands):

	Three months ended	
	March 31,	
	2003	2002
Revenues from unaffiliated customers:		
United States	\$ 332	\$ 3,512
International	47	32
Consolidated	\$ 379	\$ 3,544
Intercompany revenues:		
United States	\$ 38	\$ 25
International	148	1,468
Intercompany items and eliminations	(186)	(1,493)
Consolidated	\$	\$
Operating loss:		
United States	\$ (1,526)	\$ (891)
International	(1,683)	(631)
Consolidated	\$ (3,209)	\$ (1,522)
Identifiable assets:		
United States	\$ 2,963	\$ 11,029
International	34,754	39,238
Intercompany items and eliminations	(33,013)	(35,300)
Consolidated	\$ 4,704	\$ 14,967
Long-lived assets:		
United States	\$ 1,454	\$ 166
International	33,126	35,540
Intercompany items and eliminations	(33,013)	(35,300)
Consolidated	\$ 1,567	\$ 406

All of the international revenues and substantially all of the international identifiable assets relate to Insignia's operations in the United Kingdom. Intercompany sales are accounted for at prices intended to approximate those that would be charged to unaffiliated customers.

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Revenue by geographic area for the quarter ended March 31, 2003 was as follows (in thousands):

	U.S.	U.S. Exports	Europe	Total
Distributor	\$ 69	\$ 22	\$ 40	\$ 131
OEM	221	7	3	231
End User	4	9	4	17
Total	\$ 294	\$ 38	\$ 47	\$ 379
Percentage of total revenue	78%	10%	12%	100%

Revenue by geographic area for the quarter ended March 31, 2002 was as follows (in thousands):

	U.S.	U.S. Exports	Europe	Total
Distributor	\$ 2,858	\$ 60	\$	\$ 2,918
OEM	518	71	9	598
End User	6		22	28
Total	\$ 3,382	\$ 131	\$ 31	\$ 3,544
Percentage of total revenue	95%	4%	1%	100%

There were no foreign countries that accounted for more than 10% of total revenue.

Note 9. Equity transactions and warrants

On December 9, 1999, we entered into agreements whereby we issued 1,063,515 ordinary shares in American Depository Shares (ADS) form at a price of \$4.23 per share to Castle Creek Technology Partners LLC and four other investors of whom one is a member of our board of directors. We also issued warrants to the purchasers to purchase a total of 319,054 ADSs at the price of \$5.29 per share. The warrants expire on December 9, 2004. We received \$4.5 million less offering expenses totaling \$0.4 million. The securities were issued in reliance upon the exemption from registration provided under Regulation D promulgated under the Securities Act. An issuance of shares and warrants on November 24, 2000 has had a dilutive effect on the warrants issued in the December 9, 1999 placement, resulting in an increase in the number of ADSs issuable to 353,834, and a decrease of the exercise price to \$4.77. An issuance of shares and warrants on February 12, 2001 also triggered the anti-dilution provisions of the placement of December 9, 1999. However, the effect of such dilution was less than 1% of the exercise price, and consequently such adjustment is deferred until such time as the accumulation of this adjustment and future adjustments exceed at least 1% of the exercise price.

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During 2000, we issued a total of 19,994 ordinary shares in ADS form at various prices, ranging from \$6.281 to \$16.50 to a director of Insignia, as payment for draw down fees under a Line of

Credit arrangement entered into in March 2000. The securities were issued in reliance upon the exemption from registration provided under Section 4 (2) of the Securities Act.

On November 24, 2000 we entered into agreements whereby we issued 3,600,000 ordinary shares in ADS form at a price of \$5.00 to a total of 23 investors, including Sun Microsystems, BSquare, and a member of our board of directors. We also issued warrants to purchase 1,800,000 ADSs to the investors at an exercise price of the lower of the average quoted closing sale price of our ADSs for the ten trading days ending on the day preceding the date of the warrant holder's intent to exercise less a 10% discount, and \$6.00. The warrants expire on November 24, 2003, however, subject to certain conditions, if the quoted sale price of the ADSs exceed \$9.00 per share for any thirty consecutive trading days, we may cancel the warrants upon sixty days prior written notice. We received \$18.0 million less offering expenses totaling \$2.0 million. We also issued warrants to purchase 225,000 ADSs to the placement agent exercisable at a price of \$5.00. These warrants expire on November 24, 2005. The securities were issued in reliance upon the exemption from registration provided under Regulation D promulgated under the Securities Act.

On December 31, 2000 we issued a total of 251,333 ordinary shares in ADS form to Quantum Peripherals (Europe) SA, at a per share price of \$4.23 per share under the terms of a convertible promissory note entered into on October 20, 1999. The securities were issued in reliance upon the exemption from registration provided under Section 4 (2) of the Securities Act based on the fact that the shares were sold by the issuer in a sale not involving a public offering.

On February 12, 2001 we entered into agreements whereby we issued 940,000 ordinary shares in ADS form at a price of \$5.00 to a total of 4 investors, including Wind River Systems, Inc., and a member of our board of directors. We also issued warrants to purchase 470,000 ADSs to the investors, at an exercise price of the lower of the average quoted closing sale price of our ADSs for the ten trading days ending on the day preceding the date of the warrant holder's intent to exercise less a 10% discount, and \$6.00. The warrants expire on February 12, 2004, however, subject to certain conditions, if the quoted sale price of the ADSs exceed \$9.00 per share for any thirty consecutive trading days, we may cancel the warrants upon sixty days prior written notice. We received \$4.7 million less offering expenses totaling \$0.5 million. We also issued warrants to purchase 25,000 ADSs to the placement agent exercisable at a price of \$5.00. These warrants expire on February 12, 2006. The securities were issued in reliance upon the exemption from registration provided under Regulation D promulgated under the Securities Act.

In April 2001, three investors exercised their warrants for 282,500 ADSs. We received \$682,283, net of \$19,117 for legal fees for the warrant exercises. In March 2002, three investors exercised their warrants for 400,000 ADSs. We received \$480,400, net of \$15,400 for legal fees for the warrant exercises.

Subscription Agreement

On October 17, 2002, we entered into a securities subscription agreement (Agreement) with Fusion Capital Fund II, LLC (Fusion Capital), pursuant to which Fusion Capital has agreed to purchase, on each trading day following the effectiveness of a registration statement covering the American Depositary Shares to be purchased by Fusion Capital, \$10,000 of our American Depositary Shares up to an aggregate of \$6.0 million over a period of 30 months. The purchase price of the American Depositary Shares will be equal to a price based upon the future market price of the shares without any fixed discount to the market price. In order to be in compliance

with Nasdaq rules, we could not sell our ordinary shares to Fusion Capital at a price below \$0.38, which represents the greater of the book value per share of our ordinary shares as of September 30, 2002, or the closing sale price per share of our ADSs on October 16, 2002 which was \$0.38. If we elect to sell our shares to Fusion Capital at a price per share below \$0.38, we first would be required to obtain shareholder approval in order to be in compliance with applicable Nasdaq rules. Under the laws of England and Wales, we are not permitted to sell our ADSs at a purchase price that is less than the nominal value of our ordinary shares. Currently, the nominal value per ordinary share is the U.S. dollar equivalent of 20.5 pence. As of March 31, 2003, we had not sold any shares under this Agreement. We have incurred approximately \$350,000 in expenses which were in December 2002. As of March 31, 2003, the closing market price of our shares was \$0.22 per share. As a result, we do not anticipate selling any shares under our agreement with Fusion Capital unless and until the market price of our shares increases from current levels. In addition, the sale of our shares to Fusion Capital under the Agreement is subject to other conditions which have not been met.

Under the terms of the Agreement, we issued to Fusion Capital one redeemable warrant for American Depository Shares representing 1,000,000 ordinary shares, and one non-redeemable warrant for American Depository Shares representing 1,000,000 ordinary shares. The redeemable warrant may be redeemed by Insignia at any time on or before June 30, 2003 for an aggregate redemption price of \$200,000. The exercise price per share of each warrant is the U.S. dollar equivalent of 20.5 pence. Each warrant expires on September 30, 2007. The fair value of the warrants was estimated at \$544,000 on the date of grant using the Black-Scholes pricing model with the following assumptions: no dividend yield; risk-free rate of 2.5%; volatility of 101%; and an expected life of five years. The fair value of the warrants have been expensed in other expense entirely for the year ended December 31, 2002. Unless an event of default occurs under the Agreement, the shares issuable upon exercise of these warrants must be held by Fusion Capital until 30 months from the date of the Agreement or the date the Agreement is terminated. The warrants are immediately exercisable; however, Fusion Capital may not exercise the warrants if Fusion Capital, together with its affiliates, would beneficially own more than 9.9% of our shares outstanding at the time of the exercise by Fusion Capital. The Agreement and the forms of the Registration Rights Agreement, the Redeemable Warrant and the Non-Redeemable Warrant between Insignia and Fusion Capital are filed as Exhibits to the 8-K dated October 22, 2002.

Dilution Adjustments

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In December 1999, we issued 1,063,515 ordinary shares in ADS form at a price of \$4.23 per share through a private placement. Along with ADSs, we also issued to the investors warrants that entitle them to purchase a total of 319,054 ADSs at an exercise price of \$5.29 per ADS. As described below, the exercise price and the number of ADSs issuable under the warrants are subject to various adjustments. In addition, we may issue additional warrants that entitle the investors to purchase ADSs at the nominal value on designated adjustment dates in the future.

Under the December 1999 private placement, the investors received warrants to purchase three ADSs for every 10 ADSs they purchased. The exercise price of the warrants was set at 125% of the original per ADS purchase price, or \$5.29. However, the warrants contain anti-dilution provisions which decrease this exercise price and increase the number of ADSs purchasable if we sell or are deemed to sell any shares at below market price during the term of the warrants, which ends on December 9, 2004. The private placement that closed on November 24, 2000 was a sale which triggered the anti-dilution provisions in the warrants, and, as a consequence, the exercise

price of the warrants has been decreased from \$5.29 to \$4.77 per ADS, and the number of ADSs purchasable has increased to 353,834. The private placement on February 12, 2001 also triggered the anti-dilution provisions of the issuance of December 9, 1999. However, the effect of such dilution was less than 1% of the exercise price and consequently such adjustment is deferred until such time as the accumulation of this adjustment and future adjustments exceed at least 1% of the exercise price.

As part of their warrant agreements, the investors may be entitled to cash payments upon the occurrence of certain Major Transactions, as defined in the warrant agreements, including change of control provisions. Cash payments are determined in a methodology described in the agreement. Such methodology is impacted by market price. A major transaction is defined as a merger, reorganization, or sale of all or substantially all of the assets of Insignia in which the stockholders of Insignia immediately prior to the transaction possess less than 50% of the voting power of the surviving entity (or its parent) immediately after the transaction.

Under the December 1999 private placement, the investors were entitled to additional warrants to purchase ADSs at £0.20 nominal value per share if the average of the closing bid price of the ADSs over the ten days before an adjustment date was less than \$4.23. The adjustment dates commenced on March 10, 2000 and occurred on the 10th of each month through March 10, 2001, inclusive. The rights for an adjustment date to occur would terminate upon release of at least \$4.75 million of the funds held in escrow by Citrix on December 9, 1999. However, not enough of the funds held were released to trigger this termination. As calculated the average bid price of our ADSs on all the adjustment dates exceeded \$4.23 per share and consequently no adjustment occurred. The adjustment rights have now expired.

We obtained a third-party valuation to allocate fair value to amounts received from the private placement between the ADSs and the warrants. In 1999 the amount allocated to mandatorily redeemable warrants totaled \$1.440 million, of which \$0.590 million was allocated to the warrant, and \$0.850 million was allocated to the additional warrant. Of the remaining net proceeds received, \$2.619 million was allocated to mandatorily redeemable capital. The \$2.619 million of mandatorily redeemable capital was reclassified, when the registration statement for the ADSs and the ADSs underlying the warrants issued in the December 1999 private placement became effective on March 28, 2000, of which \$0.340 million was classified as ordinary shares and \$2.279 million was classified as additional paid-in capital.

Amounts classified as warrants will remain outside of shareholders' equity for the life of the warrant or until they are exercised, whichever occurs first. This classification reflects certain potential cash payments that may occur, should we complete a major transaction, such as a takeover, during the life of the warrants. If a major transaction had occurred as of March 31, 2003, the maximum cash payout would have been approximately \$12,030 based on the estimated Black-Scholes value of the warrant.

Limitations in the transaction agreements preclude these investors in question from achieving certain levels of beneficial ownership. The securities purchase agreement, the warrants and the additional warrants contain the restriction that we may not issue and a selling investor may not purchase, and the warrants and additional warrants may not be exercised for any ADSs if doing so would cause such investor to beneficially own more than 9.9% of the total ordinary shares in issue as determined in accordance with Section 13(d) of the Securities Exchange Act of 1934. Under the additional warrants, if such investors are prohibited from exercising the additional warrant as a result of the 9.9% restriction, the selling investor may, at its option and in addition

to its other rights under the securities purchase agreement and the warrant, retain the warrant or demand payment, in cash, from us in an amount calculated by the Black-Scholes formula multiplied by the number of ADSs for which the additional warrant was exercisable, without regard to any limits on exercise. The restrictions on the levels of beneficial ownership in these documents do not, however, restrict those investors from exercising the warrants or additional warrants up to those limitations, selling ADSs to decrease their level of beneficial ownership, and exercising the warrants to receive additional ADSs. This could result in additional dilution to the holders of our ADSs and a potential decrease in the price of the ADSs.

The following table summarizes activity on warrants:

	Warrants outstanding and exercisable	Warrants outstanding exercise price
Balance, December 31, 2001	2,591,334	\$4.77- \$6.00 (1)
Granted	2,000,000	Par value
Exercised	(400,000)	\$1.24 (1)
Balance, December 31, 2002	4,191,334	Par value - 6.00 (1)
Granted		
Exercised		
Balance, March 31, 2003	4,191,334	Par value - 6.00 (1)

The \$6.00 warrants are the lesser of \$6.00 or 90% of 10-day average market value

Note 10. Line of credit

On March 28, 2002, Insignia's U.S. subsidiary, Insignia Solutions, Inc. (Insignia U.S.) entered into an accounts receivable financing agreement with Silicon Valley Bank. The financing agreement allowed Insignia U.S. to borrow an amount up to 80% of eligible receivables not to exceed \$1,200,000, with interest at the bank's prime rate plus two percentage points. The agreement was cancelled on February 12, 2003, and the UCC filing liens on the assets of Insignia U.S. were terminated. No funds were ever borrowed under this credit facility.

Note 11. Related party transaction

During the three months ended March 31, 2003 and the twelve months ended December 31, 2002, Insignia recognized revenue of \$22,000 and \$4,200,000, respectively, from Phoenix. The CEO of Phoenix was a director on Insignia's board of directors from March 1997 until March 2001.

During the three months ended March 31, 2003 and the twelve months ended December 31, 2002, Insignia recognized revenue of \$0 and \$300,000, respectively, from Wind River Systems, Inc. (Wind River). Wind River participated in a private placement of equity in Insignia in February 2001 on the same terms as the other three investors in the private placement. Wind River paid the aggregate purchase price of \$2,000,000 for 400,000 ordinary shares represented by ADRs and warrants to purchase 200,000 additional ordinary shares represented by ADRs. In addition, a Vice President of Wind River, John C. Fogelin, was appointed to Insignia's board of directors in January 2001.

On February 13, 2001, we entered into a promissory note with Richard M. Noling, President and Chief Executive Officer of Insignia whereby Mr. Noling borrowed \$150,000 from the U.S.-based subsidiary of Insignia. The promissory note was due in three equal installments, on each annual anniversary from the date of the note. The note was amended on January 24, 2002 to extend the first and subsequent installments one year. The first installment became due on February 13, 2003. Mr. Noling's employment was terminated with Insignia effective February 14, 2003. We forgave, effective March 6, 2003, the balance of the loan, \$128,154, in lieu of any bonus compensation. Interest accrued on the unpaid principal balance at a rate per annum equal to the prime lending rate of interest as listed in the Wall Street Journal plus 1%. Accrued interest was due and payable monthly in arrears on the last calendar day of each month, beginning March 31, 2001. In addition, on July 17, 2001, Mr. Noling received an interest free loan of \$50,000. The \$50,000 loan was repaid in full on September 30, 2001.

Note 12. Restructuring

SFAS 146 (See Note 5) requires restructuring changes to be recorded at the commitment date. For the quarter ended March 31, 2003, we restructured the organization resulting in actual payments of \$117,000 and an accrual of future payments totaling \$209,000. The future payments consist of \$161,000 and \$48,000 in the second and third quarters of 2003, respectively.

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

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Part I - Item 1 of this Form 10-Q and the Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Insignia's Form 10-K for the year ended December 31, 2002 (the Form 10-K).

Future operating results

This Form 10-Q contains forward-looking statements. These forward-looking statements concern matters which include, but are not limited to, the revenue model and market for the Secure System Provisioning (SSP) product line, the features, benefits and advantages of the SSP platforms, international operations and sales, gross margins, spending levels, the availability of licenses to third-party proprietary rights, business and sales strategies, matters relating to proprietary rights, competition, exchange rate fluctuations and Insignia's liquidity and capital needs. These and other statements regarding matters that are not historical are forward-looking statements. These matters involve risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. In addition to the factors discussed above, among other factors that could cause actual results to differ materially are the following: the demand for the SSP platform; the performance and functionality of SSP technology; Insignia's ability to deliver products on time, and market acceptance of new products or upgrades of existing products; the timing of, or delay in, large customer orders; continued availability of technology and intellectual property license rights; product life cycles; quality control of products sold; competitive conditions in the industry; economic conditions generally or in various geographic areas; and the risks listed from time to time in the reports that Insignia files with the U.S. Securities and Exchange Commission. Factors that could cause or contribute to such differences in results and outcomes include without limitation those discussed below as well as those discussed elsewhere in this Report. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date hereof. Insignia assumes no obligation to update these forward-looking statements to reflect actual results or changes in factors or assumptions affecting such forward-looking statements.

Insignia continues to face significant risks associated with the successful execution of its business strategy. These significant risks include, but are not limited to continued technology and product development, introduction and market acceptance of new products, changes in the marketplace, liquidity, competition from existing and new competitors that may enter the marketplace, impairment of prepaid royalties and retention of key personnel.

In addition, Insignia also faces significant risks associated with the development and future deployment of its SSP products and the successful execution of the related business strategy. During 2001, Insignia began development of a range of SSP products for the mobile handset and wireless carrier industry. These SSP products build on Insignia's position as a Virtual Machine (VM) supplier for manufacturers of mobile devices and are designed to allow wireless carriers to execute over the air repair services and build valuable incremental services. With the sale of the Jeode business to esmertec, Insignia's sole product line consists of the SSP products. The SSP product is currently in lab and market trials and is expected to be available for shipment to customers in the second half of 2003. Insignia has limited history with sales initiatives for new

products. Additionally, the sales cycle for the SSP products is expected to take longer than the six to nine months sales cycle typically experienced with the Jeode product.

Insignia has experienced operating losses in each quarter since the second quarter of 1996. To achieve profitability, Insignia will have to increase its revenue. With the sale of the Jeode business, Insignia's ability to increase revenues depends upon the success of its SSP product line. SSP is not expected to be available until the second half of 2003, and it may not achieve widespread market acceptance. If Insignia is unable to generate revenues from SSP in the form of development license fees, maintenance and support fees, commercial use royalties and nonrecurring engineering activities, Insignia's current revenue levels will be insufficient to sustain its business.

Insignia has undertaken measures to reduce operating expenses and redesign its commercial efforts to adapt to new developments. Based upon Insignia's current forecasts and estimates, Insignia's current cash, cash equivalents and short-term investments, together with cash generated from on-going operations and other liquid sources of cash (including the cash from the sale of the Java Virtual Machine (JVM) assets) available to Insignia, may not be sufficient to meet its anticipated cash needs for working capital and capital expenditures through calendar 2003. In particular, Insignia will need to further reduce the level of operating expenses in the event that revenue is lower than expected. In addition, if Insignia is unable to maintain the reduction of operating expenses or increase revenue, if unplanned cash payments or expenses arise, or if Insignia is unable to obtain access to additional capital, it may not have sufficient resources to fund continuing operations through calendar year 2003. In addition, based on its current forecasts and estimates, Insignia anticipates that, in any event, it will require additional financing in calendar year 2004.

To the extent that Insignia requires additional financing, there can be no assurances that Insignia will be able to obtain such funding when it is needed on acceptable terms, or at all. The failure to raise such additional funds on a timely basis and on sufficiently favorable terms would have a material adverse effect on Insignia's business, operating results and financial condition. Insignia's liquidity also may be adversely affected in the future by factors such as higher interest rates, inability to borrow without collateral, limited availability of capital financing and continued operating losses.

The size of Insignia's accumulated deficit, its losses and its ongoing need for capital in order to continue its operations raises substantial doubt as to Insignia's ability to continue operations during 2003. Failure to reduce expenses and/or obtain additional financing will result in a material adverse effect on its ability to meet its business objectives and continue as a going concern. The report of the Company's independent accountants included in Insignia's Annual Report on Form 10-K filed on April 15, 2003 includes an explanatory paragraph as to the uncertainty that the Company will continue as a going concern.

Except as otherwise noted, this Form 10-Q does not reflect the anticipated sale of our JVM business to esmertec.

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The following table sets forth the unaudited condensed consolidated results of operations as a percentage of total revenues for the three month periods ended March 31, 2003 and 2002.

	Three months ended March 31,	
	2003	2002
Net revenues:		
License	50.7%	84.3%
Service	49.3%	15.7%
Total net revenues	100.0%	100.0%
Cost of net revenues:		
License	30.4%	28.6%
Service	13.7%	5.6%
Total cost of net revenues	44.1%	34.2%
Gross margin	55.9%	65.8%
Operating expenses:		
Sales and marketing	170.2%	48.6%
Research and development	344.6%	33.7%
General and administrative	301.9%	26.5%
Restructuring	86.0%	0.0%
Total operating expenses	902.7%	108.8%
Operating loss	(846.8)%	(43.0)%
Interest income (expense), net	(0.2)%	0.6%
Other income (expense), net	3.4%	(0.9)%
Loss before income taxes	(843.6)%	(43.3)%
Provision (benefit) for income taxes	0.5%	(15.8)%
Net loss	(844.1)%	(27.5)%

Overview

We commenced operations in 1986, and currently develop, market and support software technologies that implement accelerated virtual machine technology for memory-constrained smart devices. In January 1998, we announced our intention to launch a new product line called the Jeode™ platform, based on our Embedded Virtual Machine (EVM) technology. We also explored new markets that would leverage our 17 years of emulation software development experience. The Jeode platform is our implementation of Sun Microsystems, Inc. s (Sun) Java® technology tailored for smart devices. It leverages patent-pending intellectual property to provide these resource-constrained devices with high performance, fully-compatible Java applet and application support. The product became available for sale in March 1999. The Jeode platform has been our principal product line since the third quarter of 1999. The Jeode product line was sold in April 2003.

During 2001, we began development of a range of products (Secure System Provisioning or SSP products) for the mobile handset and wireless carrier industry. These SSP products build on our position as a Virtual Machine (VM) supplier for manufacturers of mobile devices and allow wireless carriers to execute over the air repair and build valuable incremental services. With the sale of our JVM business in April 2003, our sole product line will consist of our SSP product. The SSP product became available for lab and market trials in early 2003 and will be available for shipment to customers in the second half of 2003. We have limited history with sales initiatives for new products. Additionally, the sales cycle for the SSP products is expected to take longer than the typical six to nine months to complete as seen with the Jeode product.

Our operations outside of the United States are primarily in the United Kingdom, where the majority of our research and development operations and our European sales activities are located. We distribute our Jeode platform through OEM s. Our revenues from customers outside the United States are derived primarily from Europe and Asia and are generally affected by the same factors as our revenues from customers in the United States. The operating expenses of our operations outside the United States are mostly incurred in Europe and relate to our research and development and European sales activities. Such expenses consist primarily of ongoing fixed costs and consequently do not fluctuate in direct proportion to revenues. Our revenues and expenses outside the United States can fluctuate from period to period based on movements in currency exchange rates. Historically, movements in currency exchange rates have not had a material effect on our revenues.

We operate with the U.S. dollar as our functional currency, with a majority of revenues and operating expenses denominated in U.S. dollars. Pound sterling exchange rate fluctuations against the dollar can cause U.K. expenses, which are translated into dollars for financial statement reporting purposes, to vary from period-to-period.

Sale of Java Virtual Machine assets

On February 7, 2003, we entered into a \$1 million loan agreement with esmertec AG (esmertec). The loan was made in two installments of \$500,000 each on February 13, 2003 and February 26, 2003. The rate of interest on each loan is at prime plus two percent. Accrued interest is due on the last day of each month. The accrued interest as of March 31, 2003, was \$6730. The principal and any outstanding accrued interest is due on or before February 3, 2004.

On March 5, 2003, we entered into several other agreements (the Agreements) with esmertec including a definitive agreement to sell certain assets relating to our Java Virtual Machine (JVM) line of business in exchange for \$3.5 million payable in installments. Payments under the agreement would be \$800,000 on April 18, 2003, \$800,000 on July 23, 2003, \$800,000 on October 15, 2003, \$800,000 on January 15, 2004 and \$300,000 on April 15, 2004. The assets primarily included the fixed assets, customer agreements and employees related to the JVM line of business. The transaction closed on April 23, 2003. Under the terms of the Agreements, esmertec became the exclusive master distributor of the JVM technology in exchange for \$3.4 million in minimum guaranteed royalties through June 30, 2004 at which time, the JVM technology rights will transfer to esmertec. Minimum payments under the license are as follows:

DUE DATE	PAYMENT
April 30, 2003	\$ 250,000
May 15, 2003	\$ 200,000
July 15, 2003	\$ 200,000
July 31, 2003	\$ 250,000
August 15, 2003	\$ 200,000
October 15, 2003	\$ 200,000
October 31, 2003	\$ 250,000
November 15, 2003	\$ 200,000
January 15, 2004	\$ 200,000
January 31, 2004	\$ 250,000
February 15, 2004	\$ 200,000
April 15, 2004	\$ 200,000
May 15, 2004	\$ 200,000
July 15, 2004	\$ 200,000
August 15, 2004	\$ 200,000
October 15, 2004	\$ 200,000
Total	\$ 3,400,000

In addition, we can earn up to an additional \$4.0 million over the next three years based on a percentage of esmertec's future sales of the JVM product. Additionally, the parties have entered into a cooperative agreement to promote Insignia's SSP software product to esmertec's mobile platform customers. The Agreements provide for esmertec to manage the existing Insignia JVM customer relationships and license the Insignia and esmertec technologies to sell to the then combined customer base and business partners. Under the Agreements, esmertec will assume the entire JVM business through a final asset purchase in June 2004.

As part of the sale of our JVM business, we transferred 42 employees to esmertec, of which 31 were development engineers. In addition, as part of the sale, esmertec entered into an agreement with our U.K. building landlord to assume the lease on one of the two buildings leased by Insignia.

The Jeode platform has been our principal product line since the third quarter of 1999. With the sale of our JVM business to esmertec, Insignia's sole product line consists of its SSP products for the mobile handset and wireless carrier industry. The SSP product became available for lab and market trials in early 2003 and is expected to be available for shipment to customers in the second half of 2003. We have limited history with sales initiatives for new products.

Additionally, the sales cycle for the SSP products is expected to take longer than the typical six to nine months experienced to complete as seen with the Jeode product.

Except as otherwise noted, this Form 10-Q does not reflect the anticipated sale of our JVM business to esmertec.

Critical accounting policies and estimates

The consolidated financial statements are prepared in accordance with generally accepted accounting principles. Certain of our accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates. These estimates affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. By their nature, these judgments are subject to an inherent degree of uncertainty. The most significant estimates and assumptions relate to revenue recognition, the recoverability of prepaid royalties, and the adequacy of allowances for doubtful accounts. Actual amounts could differ from these estimates.

Revenue recognition

We recognize revenue in accordance with Statement of Position 97-2 (SOP 97-2), Software Revenue Recognition , as amended. SOP 97-2 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the fee is fixed or determinable; and (4) collectibility is probable. Determination of criteria (3) and (4) are based on management's judgments regarding the fixed nature of the fee charged for services rendered and products delivered and the collectibility of those fees. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

At the time of the transaction, we assess whether the fee associated with our revenue transaction is fixed or determinable and whether or not collection is reasonably assured. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction. If a significant portion of a fee is due after the normal payment terms, which are 30 to 90 days from invoice date, we account for the fee as not being fixed or determinable. In these cases, we recognize revenue on the earlier of due date or cash collected.

We assess collectability based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. We do not request collateral from our customers. If we determine that collection of a fee is not reasonably assured, we will defer the fee and recognize revenue at the time collection becomes reasonably assured, which is generally upon receipt of cash.

For all sales, we use either a signed license agreement or a binding purchase order (primarily for maintenance renewals) as evidence of an arrangement.

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For arrangements with multiple obligations (for example, undelivered maintenance and support), we will allocate revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements, which is specific to us. This means that we will defer revenue from the arrangement fee equivalent to the fair value of the undelivered elements. Fair value for the ongoing maintenance and support obligation is based upon separate

sales of renewals to other customers or upon renewal rates quoted in the contracts. Fair value of services, such as training or consulting, is based upon separate sales by us of these services to other customers.

Our arrangements do not generally include acceptance clauses. However, if an arrangement includes an acceptance provision, acceptance occurs upon the earlier of receipt of written customer acceptance or expiration of the acceptance period.

We recognize revenue for maintenance services ratably over the contract term. Our training and consulting services are billed based on hourly rates, and we will generally recognize revenue as these services are performed. However, at the time of entering into a transaction, we will assess whether or not any services included within the arrangement require us to perform significant work either to alter the underlying software or to build additional complex interfaces so that the software performs as the customer requests. If these services are included as part of an arrangement, we recognize the entire fee using the percentage of completion method. We estimate the percentage of completion based on our estimate of the total costs estimated to complete the project as a percentage of the costs incurred to date and the estimated costs to complete.

Accounts receivable and allowance for doubtful accounts

We perform ongoing credit evaluations of our customers and will adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain an allowance for estimated credit losses based upon historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within expectations and the allowance established, we cannot guarantee that we will continue to experience the same credit loss rates as in the past. Since our accounts receivable are concentrated in a relatively few number of customers, a significant change in the liquidity or financial position of any one of these customers could have a material adverse impact on the collectability of accounts receivables and future operating results.

The preparation of financial statements requires us to make estimates of the uncollectability of our accounts receivables. We specifically analyze accounts receivable and analyze historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in its customer payment terms when evaluating the adequacy of the allowance for doubtful accounts.

Prepaid royalties

Our agreements with licensors sometimes require us to make advance royalty payments and pay royalties based on product sales. Prepaid royalties are capitalized and amortized as cost of sales based on the contractual royalty rate based on actual net product sales. We continually evaluate recoverability of prepaid royalties and, if necessary, will charge to cost of sales any amount that we deem unlikely to be recoverable in the future. The prepaid royalties carried on the balance sheet, under the terms of the Distribution Agreement between Sun and Insignia, require us to use these prepaid licenses before June 30, 2004. We have performed an assessment of whether there was an indication that prepaid royalties of \$2.28 million are impaired as of March 31, 2003. Our estimation of utilization, based on past revenue history and future revenue estimates using current average per unit selling price ranges, indicates that there could be unused prepaid

royalties at the expiration of the Distribution Agreement. As part of the sale of the JVM business to esmertec, esmertec has entered into a master distribution license agreement with Insignia, whereby esmertec will license product from Insignia which will consume all the prepaids paid to Sun. However, if esmertec should breach the agreement, we believe that should unused prepaid royalties become predictable in the future, we could reduce the selling price in order to utilize the remaining prepaid balance. This price reduction would result in lower gross margins. We will continue to assess this potential impairment on a quarterly basis. The deterioration of the business climate and lower than expected product sales could potentially impact this assessment and require an impairment charge in a future quarter. Prepaid royalties are classified as both current and non-current assets based on estimated net product sales within the next year.

Revenues

	Three months ended March 31,	
	2003	2002
(in thousands)		
License revenue	\$ 192	\$ 2,988
Service revenue	187	556
Total net revenue	\$ 379	\$ 3,544

The Jeode product line was our primary business for the first quarter of 2003 and 2002. Revenue from the Jeode product line is derived from four main sources: the sale of a development license, the sale of annual maintenance and support contracts/services, prepaid royalties and commercial use royalties based on shipments of products that include Jeode technology, and nonrecurring engineering activities.

In the first quarter of 2003, total revenues decreased by 89% compared to total revenues for the first quarter of 2002. The decrease was primarily due to decreased license revenues relating to the Jeode platform product line and the March 2003 revenue transferred as part of the JVM sale to esmertec. The Jeode platform accounted for 95% and 100% of total revenue for the three months ended March 31, 2003 and 2002, respectively. Future revenue from Jeode will be earned as a percentage of the revenue share program from the sale of the JVM business. Jeode revenue will decrease from prior quarters. We expect to generate revenue from the SSP product in the second half of 2003.

License revenue and service revenue accounted for 51% and 49%, respectively, of total revenues in the first quarter of 2003. In the first quarter of 2002, license revenue and service revenue accounted for 84% and 16%, respectively.

License revenue decreased 93% in the first quarter of 2003 compared to license revenues in the first quarter of 2002. The decrease was primarily due to the decline in the Internet Appliance market and the general weakening of the economy. Jeode license revenues for the three months ended March 31, 2003 and the three months ended March 31, 2002 accounted for 90% and 100% of total license revenues, respectively. A one-time Softwindows transaction accounted for 10% of the license revenue for the three months ended March 31, 2003.

Service revenue in the first quarter of 2003 was 66% lower than service revenue in the first quarter of 2002. The decrease was primarily due to decreased Jeode engineering and Jeode

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support contracts. Jeode service revenues for the three months ended March 31, 2003 and the three months ended March 31, 2002 accounted for 100% of total service revenues.

Sales to distributors and OEM s representing more than 10% of total revenue in each period accounted for the following percentages of total revenues.

	Three months ended March 31,	
	2003	2002
Distributors:		
Hewlett Packard	34%	*
Phoenix	*	78%
All Distributors:	35%	82%
OEM s:		
All OEM s	61%	17%
Less than 10%		

Sales to customers outside the United States, derived mainly from customers in Europe and Asia, represented approximately 10% of total revenues in the three months ended March 31, 2003 and 5% of total revenues in the three months ended March 31, 2002. We marketed Jeode to customers in the United States, Europe and Japan.

Cost of revenues and gross margin

	Three months ended March 31,	
	2003	2002
	(in thousands, except percentages)	
Cost of license revenue	\$ 115	\$ 1,014
Gross margin: license revenue	40%	66%
Cost of service revenue	\$ 52	\$ 197
Gross margin: service revenue	72%	65%
Total cost of revenues	\$ 167	\$ 1,211
Gross margins: total revenues	56%	66%

Cost of license revenue is mainly comprised of royalties to third parties. Cost of service revenue includes costs associated with nonrecurring engineering activities and end-user support under maintenance contracts.

We believe that the significant factors affecting the Jeode platform gross margin include pricing of the development license, pricing of the unit usage and royalties to third parties such as Sun Microsystems, Inc. (Sun). In early 1999, we signed a five-year agreement with Sun under which Sun established us as an authorized Virtual Machine provider. Under this agreement, we are required to pay Sun a per unit royalty on each Jeode platform-enabled smart device shipped by our customers, plus a royalty on all development licenses put in place between our customers and us. In the third quarter of 2001, we amended our license agreement with Sun. The

amendment expanded the scope of the licensed technology, changed the royalty rate, limited the royalty obligations to only per units licensed, established required prepaid royalties and extended the expiration date of the contract from March 2004 to June 2004. License revenue gross margins in the quarter ended March 31, 2003 were 40%, compared to 66% for the same period in 2002. The decrease in license revenue gross margins reflected the impact of sharing the March 2003 JVM revenue while the cost per unit did not change and resulted in lower gross margins.

Gross margin for service revenue is impacted by the level of and pricing terms of nonrecurring engineering activities, which can vary from customer to customer, from contract to contract and based on the level of maintenance contracts sold. Gross margin for service revenue increased in the first quarter of 2003 to 72% from 65% in the same period of 2002 due to more favorable labor costs on fixed price engineering consulting contracts.

Operating expenses

	Three months ended March 31,	
	2003	2002
(in thousands, except percentages)		
Sales and marketing	\$ 645	\$ 1,721
Percentage of total revenues	170%	49%
Research and development	\$ 1,306	\$ 1,196
Percentage of total revenues	345%	34%
General and administrative	\$ 1,144	\$ 938
Percentage of total revenues	302%	26%

Sales and marketing expenses consist primarily of personnel and related overhead costs, salesperson commissions, advertising and promotional expenses and trade shows. Sales and marketing expenses decreased by 62% in the quarter ended March 31, 2003 from the quarter ended March 31, 2002. The primary reason for the significant decrease was attributed to the transfer of the March 2003 JVM business expenses to esmertec. The decrease primarily reflected a \$625,000 reduction in personnel costs. In addition, travel related costs decreased \$125,000 and discretionary marketing decreased \$192,000. Overhead costs allocated using headcount also decreased by \$75,000. We anticipate a moderate decrease in sales and marketing expenses in the near term as we continue to control expenses in our sales and marketing organizations.

Research and development expenses consist primarily of personnel costs, overhead costs relating to occupancy and equipment depreciation. Research and development expenses increased by 9% in the three months ended March 31, 2003 compared to the same period in 2002. The primary reason for the increase was due to the quarter ended March 31, 2003 incurring an increased overhead cost allocation using headcount of \$31,000 and the prior year quarter allocating an additional \$145,000 of research and development expenses to cost of sales for Jeode support and maintenance and Jeode nonrecurring engineering activities. The quarter ended March 31, 2002 reported greater Jeode revenue and therefore greater Jeode cost of sales than the quarter ended March 31, 2003. Additional increases in expenditures of \$38,000 in the quarter ended March 31, 2003 were a result of independent contractor costs. The increases were offset by salary and salary related cost decreases of \$97,000 primarily due to the transferring of JVM business expenses effective March 1, 2003. Research and development expenses are expected to decrease moderately in the near term.

General and administrative expenses consist primarily of personnel and related overhead costs for finance, information systems, human resources and general management. General and administrative expenses increased by 7% in the three months ended March 31, 2003 compared to the same period of 2002. The increase was primarily due to an increase in professional service

expenditures of \$226,000 related to the sale of the JVM business to esmertec. The increase was also due to the loan forgiveness to the Chief Executive Officer of \$128,000. The increase was offset in part to a \$136,000 decrease in salaries and a \$19,000 decrease in personnel related costs which consist primarily of benefits and payroll tax expenses. Salaries and personnel costs decreased due to a reduction in force in the quarter ended March 31, 2003 and the transfer of the JVM business expenses effective March 1, 2003. Expenses are expected to decrease moderately in the near term.

Restructuring

Net other income increased from expense of \$32,000 in the three months ended March 31, 2002 to income of \$13,000 in the three months ended March 31, 2003, primarily reflecting foreign exchange gains or losses in the respective periods.

For the three months ended March 31, 2003 approximately 88% of our total revenues and over 43% of our operating expenses are denominated in U.S. dollars. Most of our remaining revenues and expenses are British pound sterling denominated and consequently we are exposed to fluctuations in British pound sterling exchange rates. There can be no assurance that such fluctuations will not have a material effect on our results of operations in the future. We did not enter with any currency option hedge contracts in 2002 or the first quarter of 2003.

We have, at times, an investment portfolio of fixed income securities that are classified as available-for-sale-securities. These securities, like all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. We attempt to limit this exposure by investing primarily in short-term securities.

Provision (benefit) for income taxes