OPNET TECHNOLOGIES INC
Form 10-Q
January 30, 2004
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended December 31, 2003

OR

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

(Commission file number: 000-30931)

OPNET TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**7372**	**52-1483235**

(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification No.)**

7255 Woodmont Avenue

Bethesda, MD 20814

(Address of principal executive office)

(240) 497-3000

(Registrant s telephone number, including area code)

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

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

At January 27, 2004, there were outstanding 19,931,208 shares of common stock of the registrant.

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* The Condensed Consolidated Statements of Operations for the Three and Nine Months Ended December 31, 2002 and the Condensed Consolidated Statement of Cash Flows for the Nine Months Ended December 31, 2002 have been restated as discussed in our Annual Report on Form 10-K/A for the year ended March 31, 2003 as filed on August 19, 2003 and in Note 2 of the Notes to Condensed Consolidated Financial Statements contained herein.

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PART 1. FINANCIAL INFORMATION

ITEM 1. ***Condensed Consolidated Financial Statements***

OPNET TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

(unaudited)

	December 31, 2003	March 31, 2003
		(As restated, see Note 2)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 33,937	$ 70,251
Marketable securities	44,622	
Accounts receivable, net of $349 and $333 in allowance for doubtful accounts at December 31 and March 31, 2003, respectively	6,871	6,420
Unbilled accounts receivable	2,090	933
Prepaid expenses and other current assets	2,106	1,412
Total current assets	89,626	79,016
Property and equipment, net	6,425	7,008
Intangible assets, net	1,370	1,566
Goodwill	12,212	12,212
Deferred income taxes and other assets	1,561	839
Total assets	$ 111,194	$ 100,641
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 111	$ 215
Accrued liabilities	3,716	2,756
Deferred and accrued income taxes	223	172
Deferred revenue	11,718	9,694
Total current liabilities	15,768	12,837
Notes payable	300	300
Deferred rent	913	632
Deferred revenue	605	484
Total liabilities	17,586	14,253
Commitments and contingencies (Note 11)		

Stockholders equity:		
Preferred stock - par value $0.001; 5,000 shares authorized, no shares issued and outstanding at December 31 and March 31, 2003		
Common stock-par value $0.001; 100,000 authorized; 26,033 and 25,522 shares issued at December 31 and March 31, 2003, respectively; 19,899 and 19,388 shares outstanding at December 31 and March 31, 2003, respectively	26	26
Additional paid-in capital	77,082	73,600
Deferred compensation	(52)	(59)
Retained earnings	20,630	16,903
Accumulated other comprehensive income	22	18
Treasury stock, at cost - 6,134 shares at December 31 and March 31, 2003	(4,100)	(4,100)
Total stockholders equity	93,608	86,388
Total liabilities and stockholders equity	$ 111,194	$ 100,641

See accompanying notes to condensed consolidated financial statements.

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OPNET TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	**2002**	**2003**	**2002**
		(As restated, see Note 2)		**(As restated, see Note 2)**
Revenues:				
New software licenses	$ 7,113	$ 5,594	$ 19,987	$ 15,833
Software license updates and technical support	3,940	3,244	10,907	9,370
Professional services	3,379	2,966	9,244	8,866
Total revenues	14,432	11,804	40,138	34,069
Cost of revenues:				
New software licenses	126	205	614	585
Software license updates and technical support	445	379	1,188	1,283
Professional services	2,048	1,192	5,302	3,472
Amortization of acquired technology	125	126	375	377
Total cost of revenues	2,744	1,902	7,479	5,717
Gross profit	11,688	9,902	32,659	28,352
Operating expenses:				
Research and development	3,144	3,200	9,450	9,575
Sales and marketing	4,964	4,530	14,044	13,500
General and administrative	1,438	1,251	4,208	3,619
Total operating expenses	9,546	8,981	27,702	26,694
Income from operations	2,142	921	4,957	1,658
Interest and other income, net	135	192	436	716
Income before provision for income taxes	2,277	1,113	5,393	2,374
Provision for income taxes	658	279	1,666	595
Net income	$ 1,619	$ 834	$ 3,727	$ 1,779
Basic net income per common share	$ 0.08	$ 0.04	$ 0.19	$ 0.09
Diluted net income per common share	$ 0.08	$ 0.04	$ 0.18	$ 0.09

Basic weighted average common shares outstanding	19,759	19,299	19,605	19,242
Diluted weighted average common shares outstanding	20,906	20,046	20,489	19,940

See accompanying notes to condensed consolidated financial statements.

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OPNET TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended December 31,	
	2003	2002
		(As restated, see Note 2)
Cash flows from operating activities:		
Net income	$ 3,727	$ 1,779
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,568	1,583
Provision for losses on accounts receivable	72	270
Deferred income taxes	(358)	(626)
Expense related to employee and other stock options	158	41
Changes in assets and liabilities:		
Accounts receivable	(1,680)	302
Prepaid expenses and other current assets	(827)	(341)
Refundable income taxes		1,230
Other assets	(98)	(57)
Accounts payable	(104)	66
Accrued liabilities	960	(322)
Accrued income taxes	(82)	84
Tax benefit from exercise of stock options	957	265
Deferred revenue	2,145	1,137
Deferred rent	281	198
Net cash provided by operating activities	6,719	5,609
Cash flows from investing activities:		
Purchase of property and equipment	(610)	(621)
Purchase of investments	(60,622)	
Proceeds from sale/maturity of investments	16,000	
Acquired technology	(179)	
Net cash used in investing activities	(45,411)	(621)
Cash flows from financing activities:		
Proceeds from exercise of common stock options	2,062	282
Proceeds from issuance of common stock under employee stock purchase plan	312	310
Proceeds from issuance of note payable		150
Net cash provided by financing activities	2,374	742
Effect of exchange rate changes on cash and cash equivalents	4	(16)

Net (decrease) increase in cash and cash equivalents	(36,314)	5,714
Cash and cash equivalents, beginning of period	70,251	62,240
Cash and cash equivalents, end of period	$ 33,937	$ 67,954

See accompanying notes to condensed consolidated financial statements.

OPNET TECHNOLOGIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation, Nature of Operations, and Significant Accounting Policies

OPNET Technologies, Inc. (OPNET , we or us) is a leading provider of management software for networks and applications. Our solutions address: application performance troubleshooting; network configuration auditing; network capacity and resiliency planning; application deployment planning; and network technology R&D. We sell our products to corporate enterprises, government and defense agencies, network service providers, and network equipment manufacturers. We market our product suite in North America primarily through a direct sales force and, to a lesser extent, several resellers and original equipment manufacturers. Internationally, we conduct research and development through our wholly-controlled subsidiary in Ghent, Belgium and market our products through our wholly-owned subsidiaries in Paris, France; Reading, United Kingdom; and Sydney, Australia; third-party distributors; and value-added resellers. OPNET is headquartered in Bethesda, MD and has offices in Cary, NC; Dallas, TX; and Santa Clara, CA.

The accompanying condensed consolidated financial statements include our results and the results of our wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The interim condensed consolidated financial statements included herein are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (the SEC) regarding interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes thereto contained in the Company s Annual Report on Form 10-K/A, Amendment No. 1, for the year ended March 31, 2003, filed with the SEC. The March 31, 2003 condensed consolidated balance sheet included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP. In the opinion of management, these interim condensed consolidated financial statements reflect all adjustments of a normal and recurring nature necessary to present fairly our results for the interim periods. The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amount of revenues and expenses during the reporting periods. Actual results could differ from those estimates. In addition, our operating results for the three and nine months ended December 31, 2003 may not be indicative of the operating results for the full fiscal year or any other future period.

Reclassifications. Fees and costs associated with the sale of periodic unspecified product updates (license updates) and technical support have been combined and presented as Software license updates and technical support in the accompanying condensed consolidated statements of operations. License update revenues of $2.2 million and $5.9 million for the three and nine months ended December 31, 2002, respectively, were reclassified from license revenues to software license updates and technical support revenues. Cost of license update revenues of $21,000 and $45,000 for the three and nine months ended December 31, 2002, respectively, were reclassified from cost of license revenues to cost of software license updates and technical support revenues. Technical support revenues of $1.1 million and $3.5 million for the three and nine months ended December 31, 2002, respectively, were reclassified from service revenues to software license updates and technical support revenues. Cost of technical support revenues of $358,000 and $1.2 million for the three and nine months ended December 31, 2002, respectively, were reclassified from cost of service revenues to cost of software license updates and technical support revenues.

Investments. We consider all highly liquid investments with maturities of three months or less when purchased to be cash equivalents. We have determined that all of our marketable securities are to be classified as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported in stockholders equity in the accompanying condensed consolidated balance sheets under the caption Accumulated other comprehensive income. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity using the effective interest method. Such amortization is included in the Interest and other income, net line item on the accompanying condensed consolidated statements of operations. Realized gains and losses on available-for-sale securities are included in the "Interest and other income, net" line item on the condensed consolidated statements of operations. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in the "Interest and other income, net" line item on the condensed consolidated statements of operations.

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Indemnifications. Under the terms of substantially all of our license agreements, we have agreed to indemnify customers for costs and damages arising from claims against such customers based on allegations that our software products infringe the intellectual property rights of a third party. The indemnification is limited to the amount paid by the customer. To date, we have not had to reimburse any of our customers for any losses related to these indemnification provisions and no claims are outstanding as of December 31, 2003. For several reasons, including the lack of prior indemnification claims, we cannot determine the maximum amount of potential future payments, if any, related to such indemnification provisions. However, we do not believe that these indemnification provisions will have a material adverse effect on the Company s operating performance or financial condition.

Our standard license agreement includes a warranty provision for software products. We generally warrant for the first ninety days after delivery that the software will operate substantially as stated in the then current documentation provided that the software is used in a supported computer system. We provide for the estimated cost of product warranties based on specific warranty claims, provided that it is probable that a liability exists and provided the amount can be reasonably estimated. To date, we have not had any material costs associated with these warranties.

Stock-Based Compensation. We account for stock-based compensation given to employees using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and accordingly, recognize compensation expense for fixed stock option grants only when the exercise price is less than the quoted market price of the shares on the date of the grant. Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, permits the use of either a fair-value based method or the intrinsic value method provided in APB Opinion No. 25 to account for employee stock-based compensation arrangements. Companies that elect to use the intrinsic value method provided in APB Opinion No. 25 are required to disclose the pro forma net income (loss) and earnings (loss) per share that would have resulted from the use of the fair value method. We have provided below the pro forma disclosures of the effect on net income and earnings per share for the three and nine months ended December 31, 2003 and 2002, as if SFAS No. 123 had been applied in measuring compensation expense for all periods.

	Three Months Ended December 31,		**Nine Months Ended December 31,**	
	2003	**2002**	**2003**	**2002**
	(In thousands, except per share data)			
Net income	$ 1,619	$ 834	$ 3,727	$ 1,779
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	8	12	26	42
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,018)	(803)	(2,983)	(2,607)
Pro forma net income (loss)	$ 609	$ 43	$ 770	$ (786)
Basic net income (loss) per common share:				
As reported	$ 0.08	$ 0.04	$ 0.19	$ 0.09
Pro forma	$ 0.03	$ 0.00	$ 0.04	$ (0.04)
Diluted net income (loss) per common share:				
As reported	$ 0.08	$ 0.04	$ 0.18	$ 0.09
Pro forma	$ 0.03	$ 0.00	$ 0.04	$ (0.04)

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2. Restatement

Subsequent to the issuance of our consolidated financial statements as of March 31, 2003, we concluded that a portion of the revenue from certain software arrangements should have been deferred to account for the value of certain free training offered to our customers. We also determined that amortization of acquired technology should be included as a cost of revenue rather than as an operating expense. As a consequence, our condensed consolidated financial statements for the three and nine months ended December 31, 2002, have been restated. For the three months ended December 31, 2002, this restatement increased our previously reported revenue from $11,696,000 to $11,804,000 and increased our previously reported net income from $753,000 to $834,000, but had no effect on our previously reported diluted earnings per common share of $0.04. For the nine months ended December 31, 2002, this restatement increased our previously reported revenue from $34,047,000 to $34,069,000 and increased our previously reported net income from $1,762,000 to $1,779,000, but had no effect on our previously reported diluted earnings per common share of $0.09. The restatement resulted in a decrease in new software license revenues of $142,000 and an increase in professional service revenues of $250,000 for the three months ended December 31, 2002. The restatement resulted in a decrease in new software license revenues of $573,000 and an increase in professional services revenues of $595,000 for the nine months ended December 31, 2002.

The effect of the reclassification of amortization of acquired technology was to increase previously reported cost of revenues and reduce previously reported gross profit by $126,000 and $377,000 for the three and nine months ended December 31, 2002, respectively. This change has no impact on net income.

A summary of the significant effects of the restatement is as follows:

Condensed Consolidated Statement of Operations Data:

	Three Months Ended December 31, 2002		Nine Months Ended December 31, 2002	
	As previously reported	As restated	As previously reported	As restated
	(in thousands, except per share data)			
Revenues	$ 11,696	$ 11,804	$ 34,047	$ 34,069
Gross profit	9,920	9,902	28,705	28,352
Income before provision for income taxes	1,005	1,113	2,351	2,374
Net income	753	834	1,762	1,779
Basic net income per common share	$ 0.04	$ 0.04	$ 0.09	$ 0.09
Diluted net income per common share	$ 0.04	$ 0.04	$ 0.09	$ 0.09

3. Marketable Securities

Marketable securities as of December 31, 2003, consist of the following:

	Amortized Cost	Gross Unrealized	Gross Unrealized	Market Value

		Gain	Loss	
		(in thousands)		
Corporate bonds and notes	$ 12,794	$	$ 4	$ 12,790
U.S. Government agencies	31,821	15	4	31,832
Marketable securities	$ 44,615	$ 15	$ 8	$ 44,622

Our marketable securities have maturity dates of less than one year.

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4. Intangible Assets

Intangible assets consisted of the following:

	At December 31, 2003	At March 31, 2003
	(in thousands)	
Acquired technology	$ 2,678	$ 2,501
Accumulated amortization	(1,308)	(935)
Intangible assets, net	$ 1,370	$ 1,566

In December 2003, we purchased a software product used primarily for modeling voice communications for approximately $179,000.

Acquired technology relating to the NetMaker and WDM NetDesign acquisitions resulted in amortization expense for the three months ended December 31, 2003 and 2002 of $125,000 and $126,000, respectively. Amortization expense for the nine months ended December 31, 2003 and 2002 was $375,000 and $377,000, respectively. Amortization expense from acquired technology is included in cost of revenues in the condensed consolidated statements of operations. We expect amortization expense of $509,000 in the fiscal year ending March 31, 2004, $536,000 in each of the fiscal years ending March 31, 2005 and 2006, $102,000 in the year ending March 31, 2007, $36,000 in the fiscal year ending March 31, 2008, and $26,000 in the fiscal year ending March 31, 2009.

5. Credit Agreement

Effective June 10, 2002, we entered into a credit facility with a commercial bank. The credit facility permits the use of funds for general corporate purposes and the issuance of letters of credit up to a maximum of $10.0 million in the aggregate. Borrowings under the credit facility are limited to 80% of eligible accounts receivable. We used the facility to issue an irrevocable letter of credit for approximately $2.8 million to satisfy the security deposit requirements for our corporate office lease. Upon a default, as defined in the corporate office lease agreement, and written notice from the landlord to us, the landlord has the right to draw upon the letter of credit in whole or in part. Interest is payable monthly, based on LIBOR plus the applicable margin ranging from 2% to 2.5% as stated in the loan agreement. The credit facility includes a fee in the amount of 0.25% per annum on the unused portion of the credit facility. The credit facility is collateralized by our accounts receivable. The loan agreement contains customary affirmative and negative covenants including a restriction on the payment of dividends and a financial covenant requiring that we not exceed a ratio of Funded Debt to EBITDA of 2.5:1.0 as such terms are defined in the loan agreement. The credit facility expires June 10, 2004. As of December 31, 2003, we had no borrowings under the available credit facility, and available borrowings at that date were $2.9 million.

6. Stockholders Equity

During the nine months ended December 31, 2003, we received proceeds of approximately $2.1 million and issued 473,003 shares of common stock, pursuant to employee exercises of stock options. During the nine months ended December 31, 2003 employees purchased 37,515 shares of common stock under the OPNET 2000 Employee Stock Purchase Plan, resulting in proceeds to us of approximately $0.3 million.

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7. Net Income per Common Share

The following is a reconciliation of the amounts used in calculating basic and diluted net income per common share for the three and nine months ended December 31, 2003 and 2002:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	**2002**	**2003**	**2002**
	(in thousands, except per share data)			
Net Income (Numerator):				
Basic and diluted net income	$ 1,619	$ 834	$ 3,727	$ 1,779
Shares (Denominator):				
Weighted average shares outstanding (basic)	19,759	19,299	19,605	19,242
Plus:				
Effect of other dilutive securities options	1,147	747	884	698
Weighted average shares outstanding (diluted)	20,906	20,046	20,489	19,940
Net income per common share:				
Basic	$ 0.08	$ 0.04	$ 0.19	$ 0.09
Diluted	$ 0.08	$ 0.04	$ 0.18	$ 0.09

We had options for the purchase of 474,500 and 2,141,464 common shares that were excluded from the diluted average shares outstanding for the three months ended December 31, 2003 and 2002, respectively, because they were antidilutive. We had options for the purchase of 1,449,692 and 2,169,464 common shares for the nine months ended December 31, 2003 and 2002, respectively, because they were antidilutive.

8. Business Segment and Geographic Information

We operate in one industry segment, the development and sale of computer software programs and related services. Revenues from transactions with U.S. Government agencies were approximately 46% and 34% of total revenues for the three months ended December 31, 2003 and 2002, respectively. Revenues from transactions with U.S. Government agencies were approximately 46% and 38% for the nine months ended December 31, 2003 and 2002, respectively. Substantially all assets were held in the United States at December 31 and March 31, 2003. Revenues by geographic area and as a percentage of total revenues is as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	**2002**	**2003**	**2002**
	(dollars in thousands)			
Geographic Area:				
United States	$ 12,274	$ 9,126	$ 32,906	$ 27,503

International	2,158	2,678	7,232	6,566
Total revenue	$ 14,432	$ 11,804	$ 40,138	$ 34,069
Geographic Area:				
United States	85.0%	77.3%	82.0%	80.7%
International	15.0	22.7	18.0	19.3
Total revenue	100.0%	100.0%	100.0%	100.0%

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9. Supplemental Cash Flow Information

	Nine Months Ended December 31,	
	2003	2002
	(in thousands)	
Cash paid for:		
Income taxes	$ 1,377	$ 79
Interest	48	53

10. Comprehensive Income

Comprehensive income includes net income, foreign currency translation adjustments, and unrealized gain on marketable securities. Total comprehensive income is summarized as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	2002	2003	2002
	(in thousands)			
Net income	$ 1,619	$ 834	$ 3,727	$ 1,779
Foreign currency translation adjustments	48	(5)	(3)	(16)
Unrealized gain on marketable securities	7		7	
Total comprehensive income	$ 1,674	$ 829	$ 3,731	$ 1,763

11. Commitments and Contingencies

We are involved in various claims and legal proceedings arising from our normal operations. We do not expect those matters, individually or in the aggregate, to have a material effect on our financial condition or results of operations.

12. New Accounting Pronouncements

In November 2002, the Financial Accounting Standards Board (FASB) issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Interpretation No. 45 requires a guarantor to include disclosure of certain obligations, and if applicable, at the inception of the guarantee, recognize a liability for the fair value of other certain obligations undertaken in issuing a guarantee. The recognition requirement was effective for guarantees issued or modified after December 31, 2002. We adopted Interpretation No. 45 effective December 2002 and the applicable disclosures have been made.

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Issue 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of Issue 00-21 apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003 but do not supersede existing authoritative guidance, including SOP 97-2. The adoption of Issue 00-21 did not have an impact on our consolidated results of operations or financial position.

In January 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. Interpretation No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors 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. We adopted the provisions of Interpretation No. 46 effective January 1, 2003. We do not have any variable interest entities; thus adoption of Interpretation No. 46 did not have an impact on our consolidated results of operations or financial position.

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In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging. The statement requires that contracts with comparable characteristics be accounted for similarly and clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except in certain circumstances, and for hedging relationships designated after June 30, 2003. We currently do not hedge foreign exchange rate risk nor have we entered into any derivative instruments or transactions that are subject to SFAS No. 133 or SFAS No. 149. We adopted SFAS No. 149, effective July 1, 2003. The adoption of this standard did not have an effect on our consolidated results of operations or financial position.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. We are not currently a party to any of the types of financial instruments that are subject to SFAS No. 150.

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ITEM 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis relate to our financial condition and results of operations for the three and nine months ended December 31, 2003 and 2002, and should be read in conjunction with our condensed consolidated financial statements and the related notes included elsewhere in this report. You should also read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K/A, Amendment No. 1, for the year ended March 31, 2003, filed with the SEC.

This report contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, and would or similar words. You should read statements that contain these words carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict or control accurately. The factors listed in this section, as well as any cautionary language contained herein, provide examples of risks, uncertainties, and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should also carefully review the risks outlined in other documents that we file from time to time with the Securities and Exchange Commission, including our Quarterly Reports on Form 10-Q that we will file in fiscal 2004.

Overview

We derive revenues from three primary sources: (1) new software licenses, (2) software license updates and technical support, and (3) professional services, which include consulting and training services. New software license revenues represent all fees earned from granting customers licenses to use our software, and exclude revenues derived from software license updates, which are included in software license updates and technical support revenues. The majority of our new software license revenues consist of perpetual license sales of our software products. Software license updates and technical support revenues represent fees associated with the sale of license updates and technical support under our maintenance agreements. We offer professional services, generally under fixed-price agreements, primarily to provide product customization and enhancements and to facilitate the adoption of our technology.

Revenues from sales outside of the United States represented 15.0%, and 22.7% of our total revenues for the three months ended December 31, 2003 and 2002, respectively. Revenues from sales outside of the United States represented 18.0% and 19.3% of our total revenues for the nine months ended December 31, 2003 and 2002, respectively. Sales outside the United States were made through our international sales team as well as third-party distributors and value-added resellers, who generally are responsible for providing technical support and service to customers within their territory. We expect revenues from sales outside the United States to continue to account for a significant portion of our total revenues in the future. We believe that continued growth and profitability will require further expansion of our sales, marketing and customer service functions in international markets.

Reclassifications

Revenues and costs associated with the sale of license updates and technical support have been combined and presented as Software license updates and technical support in the accompanying condensed consolidated statements of operations. These reclassifications had no impact on total revenues, net income, or net income per common share for the three and nine months ended December 31, 2002. See Note 1 Significant Accounting Policies - Reclassifications in the accompanying notes to our condensed consolidated financial statements for additional information regarding the reclassifications.

Restatement

As discussed in Note 2 to the condensed consolidated financial statements included under Item 1, we have restated our condensed consolidated financial statements for the three and nine months ended December 31, 2002. This Management s Discussion and Analysis reflects the restatement.

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Results of Operations

The following table sets forth items from our statements of operations expressed as a percentage of total revenues for the periods indicated:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	2002	2003	2002
Revenues:				
New software licenses	49.3%	47.4%	49.8%	46.5%
Software license updates and technical support	27.3	27.5	27.2	27.5
Professional services	23.4	25.1	23.0	26.0
Total revenues	100.0	100.0	100.0	100.0
Cost of revenues:				
New software licenses	0.9	1.7	1.5	1.7
Software license updates and technical support	3.1	3.2	3.0	3.8
Professional services	14.2	10.1	13.2	10.2
Amortization of acquired technology	0.8	1.1	0.9	1.1
Total cost of revenues	19.0	16.1	18.6	16.8
Gross profit	81.0	83.9	81.4	83.2
Operating expenses:				
Research and development	21.8	27.1	23.6	28.1
Sales and marketing	34.4	38.4	35.0	39.6
General and administrative	10.0	10.6	10.4	10.6
Total operating expenses	66.2	76.1	69.0	78.3
Income from operations	14.8	7.8	12.3	4.9
Interest and other income, net	1.0	1.6	1.1	2.1
Income before provision for income taxes	15.8	9.4	13.4	7.0
Provision for income taxes	4.6	2.3	4.1	1.8
Net income	11.2%	7.1%	9.3%	5.2%

The following table sets forth, for each component of revenues, the cost of these revenues as a percentage of the related revenues for the periods indicated:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2003	2002	2003	2002
Cost of Revenues:				
New software licenses	1.8%	3.7%	3.1%	3.7%
Software license updates and technical support	11.3	11.7	10.9	13.7
Professional services	60.6	40.2	57.4	39.2

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Revenues

New Software License Revenues. New software license revenues were $7.1 million and $5.6 million for the three months ended December 31, 2003 and 2002, respectively, representing an increase of 27.2%. New software license revenues were $20.0 million and $15.8 million for the nine months ended December 31, 2003 and 2002, respectively, representing an increase of 26.2%. The growth in sales was primarily due to higher sales volumes to enterprise and U.S. Government customers of *OPNET SP Guru and OPNET Modeler,* which were available throughout all of the periods presented, as well as *OPNET VNE Server*, which was launched in June 2002.

We may experience a slower rate of growth, or even a decline, in overall new software license revenues in the near-term due to potentially lower spending levels by enterprise IT organizations, service providers and network equipment manufacturers as a result of a challenging economy.

Software License Updates and Technical Support Revenues. Software license updates and technical support revenues were $3.9 million and $3.2 million in the three months ended December 31, 2003 and 2002, respectively, representing an increase of 21.5%. Software license updates and technical support revenues were $10.9 million and $9.4 million in the nine months ended December 31, 2003 and 2002, respectively, representing an increase of 16.4%. Software license updates and technical support revenue growth rates are affected by the overall new software license revenue growth rates, as well as the renewal rate of annual maintenance contracts by existing customers. The increases reflect the growth in the overall customer installed base as compared to the prior periods.

We may experience a slower rate of growth, or even a decline, in overall software license updates and technical support revenues in the near-term due to potentially lower spending levels by enterprise IT organizations, service providers and network equipment manufacturers as a result of a challenging economy.

Professional Service Revenues. Professional service revenues were $3.4 million and $3.0 million in the three months ended December 31, 2003 and 2002 respectively. Consulting services revenue accounted for 87.4% and 88.1% of professional service revenues for the three months ended December 31, 2003 and 2002, respectively. Professional service revenues were $9.2 million and $8.9 million in the nine months ended December 31, 2003 and 2002, respectively. For the nine months ended December 31, 2003 and 2002, consulting services revenue accounted for 87.0% and 89.4% of professional service revenues, respectively. For the three and nine months ended December 31, 2003, the increases in professional services revenue were primarily due to higher demand for our consulting services. In January 2003, we were awarded a re-competed consulting contract with the U.S. Department of Defense that contributed 15.1% and 24.5% of professional service revenues for the three and nine months ended December 31, 2003, respectively. The funding under this contract for calendar year 2003 was $3.1 million. Under the first of four possible contract extensions, the funding under this contract for calendar 2004 is $3.5 million. The option years for calendar years 2005, 2006, and 2007 under this contract, may be exercised by the U.S. Department of Defense at its discretion. Engagements with U.S. government agencies contributed significantly to the demand for our consulting services for the three and nine months ended December 31, 2003 and 2002.

Our ability to increase professional service revenues will be dependent on our ability (i) to expand our installed base of customers, (ii) to maintain several large consulting contracts with the U.S. Government and (iii) to attract and retain additional qualified consultants, including those with security clearances.

International Revenues. Our international revenues decreased 19.4% to $2.2 million, or 15% of total revenues, for the three months ended December 31, 2003 from $2.7 million, or 22.7% of total revenues, for the three months ended December 31, 2002. Our international revenues increased 10.1% to $7.2 million, or 18.0% of total revenues, for the nine months ended December 31, 2003 from $6.6 million, or 19.3% of total revenues, for the nine months ended December 31, 2002. Our international revenues are primarily generated in Europe and Japan. The challenging global economy can lengthen our sales cycle for international customers and therefore impact the timing of sales orders. We believe that we will need to further expand our international sales, marketing and customer service functions to increase international revenues. We expect to continue experiencing fluctuations of international revenues in the future.

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Cost of Revenues

Cost of new software license revenues consists primarily of royalties, media, manuals, and distribution costs. Cost of software license updates and technical support revenues consists of royalties, media, distribution costs, and personnel-related costs in providing technical support to our customers. Cost of professional service revenues consists primarily of personnel-related costs in providing consulting and training to customers. Gross margin on new software license revenues is substantially higher than gross margin on professional service revenues, due to the low materials, packaging and other costs of software products compared with the relatively high personnel costs associated with providing professional services.

In connection with our acquisitions of NetMaker in March 2001 and WDM NetDesign in January 2002, we recorded acquired technology of $2.5 million. These acquired technologies are being amortized on a straight-line basis over five years. Amortization expense from acquired technology for the three months ended December 31, 2003 and 2002 was $125,000 and $126,000, respectively. Amortization expense from acquired technology for the nine months ended December 31, 2003 and 2002 was $375,000 and $377,000, respectively.

Cost of New Software License Revenues. Cost of new software license revenues was $126,000 and $205,000 for the three months ended December 31, 2003 and 2002, respectively. Gross margin on new software license revenues increased to 98.2% for the three months ended December 31, 2003 from 96.3% for the three months ended December 31, 2002. The increase in gross margins for the three months ended December 31, 2003 was due to an increase in revenue and proportionately fewer license sales requiring royalty payments. Cost of new software license revenues was $614,000 and $585,000 for the nine months ended December 31, 2003 and 2002, respectively. Gross margin on new software license revenues increased to 96.9% for the nine months ended December 31, 2003 from 96.3% for the nine months ended December 31, 2002.

Cost of Software License Updates and Technical Support Revenues. Cost of software license updates and technical support revenues was $445,000 and $379,000 for the three months ended December 31, 2003 and 2002, respectively. Gross margin on software license updates and technical support revenues increased to 88.7% for the three months ended December 31, 2003 from 88.3% for the three months ended December 31, 2002. Cost of software license updates and technical support revenues was $1.2 million and $1.3 million for the nine months ended December 31, 2003 and 2002, respectively. Gross margin on software license updates and technical support revenues increased to 89.1% for the nine months ended December 31, 2003 from 86.3% for the nine months ended December 31, 2002. The improvements in gross margin on software license updates and technical support revenues were due to higher revenues.

Cost of Professional Service Revenues. Cost of professional service revenues was $2.0 million and $1.2 million for the three months ended December 31, 2003 and 2002, respectively. Gross margin on professional service revenues decreased to 39.4% for the three months ended December 31, 2003 from 59.8% for the three months ended December 31, 2002. Cost of professional service revenues was $5.3 million and $3.5 million for the nine months ended December 31, 2003 and 2002, respectively. Gross margin on professional service revenues decreased to 42.6% for the nine months ended December 31, 2003 from 60.8% for the nine months ended December 31, 2002. The increase in cost of professional service revenues and the resulting lower gross margins were primarily due to an increase in headcount, overhead costs, recruiting expenses and certain other costs associated with specific consulting engagements. For the three months ended December 31, 2003, our gross margin decline was partially due to lower productivity associated with new hires in consulting to meet demand for our services and subcontractor costs incurred to meet demand for engagements requiring security clearances. We expect cost of professional services revenues as a percentage of professional services revenue to vary based primarily on the profitability of individual consulting engagements.

Operating Expenses

Research and Development. Research and development expenses were $3.1 million and $3.2 million for the three months ended December 31, 2003 and 2002, respectively, representing a decrease of 1.8%. Research and development expenses were $9.5 million and $9.6 million for the nine months ended December 31, 2003 and in 2002, respectively, representing a decrease of 1.3%. The decreases were the result of lower overhead costs, offset in part by higher personnel costs. We believe that a significant level of research and development investment will be required to maintain our competitive position and broaden our product lines, as well as enhance the features and functionality of our current products. We expect that the absolute dollar amount of these expenditures to grow but generally decrease as a percentage of total revenues in future periods. Our ability to decrease these expenses as a percentage of revenues, however, will depend upon our revenue growth, among other factors.

Sales and Marketing. Sales and marketing expenses were $5.0 million and $4.5 million for the three months ended December 31, 2003 and 2002, respectively, representing an increase of 9.6%. Sales and marketing expenses were $14.0 million and $13.5 million for the nine months ended December 31, 2003 and 2002, respectively, representing an increase of 4%. The increases were primarily due an increase in the average size of our direct sales force, higher sales commission cost associated with growth in revenues, and increases in recruiting and travel costs. We anticipate that we will continue to commit substantial resources to sales and marketing and that sales and marketing expenses may increase both in absolute dollars and as a percentage of total revenues in the future periods.

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General and Administrative. General and administrative expenses were $1.4 million and $1.3 million for the three months ended December 31, 2003 and 2002, respectively. General and administrative expenses were $4.2 million and $3.6 million for the nine months ended December 31, 2003 and 2002, respectively. The increases were primarily due to higher audit fees, annual shareholder meeting expenses, insurance costs and software maintenance costs associated with new financial systems that were deployed in April 2003. The increases were partially offset by lower bad debt expenses. We expect the dollar amount of general and administrative expenses to increase as we continue to expand our operations but generally decrease as a percentage of total revenues in future periods. Our ability to decrease these expenses as a percentage of revenues, however, will depend upon our revenue growth, among other factors.

Interest and Other Income, Net

Interest and other income, net were $135,000 and $192,000 for the three months ended December 31, 2003 and 2002, respectively. Interest and other income, net were $436,000 and $716,000 for the nine months ended December 31, 2003 and 2002, respectively. The decrease in each period was primarily due to lower yields on our cash, cash equivalents and marketable securities as a result of lower interest rates.

Provision for Income Taxes

Our effective tax rates were approximately 29% and 25% for the three months ended December 31, 2003 and 2002, respectively. The effective tax rates were 31% and 25% for the nine months ended December 31, 2003 and 2002, respectively. The effective tax rate differs from the statutory tax rate and varies from period to period due principally to the amount of income before taxes from various tax jurisdictions and the amount of tax credits available to us in each period from incremental research expenditures. In November 2003, Maryland approved our application for a research and development tax credit for fiscal year 2002 in the amount of approximately $84,000. The effective tax rates for the three and nine months ended December 31, 2003 were favorably impacted by the Maryland research and development tax credit.

We expect our effective tax rate in the near-term to range from 32% to 34%; however, future provisions for taxes will depend, among other things, on the mix and amount of worldwide income, the tax rates in effect for various tax jurisdictions and the amount of increased research tax credits.

Liquidity and Capital Resources

Since inception, we have funded our operations primarily through cash provided by operating activities and through the sale of equity securities. In August 2000, we completed our initial public offering in which we raised approximately $54.1 million, net of underwriting discounts and offering expenses payable by us. As of December 31, 2003, we had cash, cash equivalents and marketable securities totaling $78.6 million.

Cash provided by operating activities was $6.7 million and $5.6 million for the nine months ended December 31, 2003 and 2002, respectively. Cash provided by operating activities is primarily derived from net income, as adjusted for non-cash items such as depreciation and amortization expense and changes in operating assets and liabilities. The increase in cash provided by operating activities in the nine months ended December 2003 from the nine months ended December 31, 2002 was primarily attributable to higher net income and deferred revenue, due to our revenue growth. The increases were partially offset by an increase in accounts receivable resulting from our revenue growth and an increase in prepaid expenses.

Net cash used in investing activities was $45.4 million and $621,000 for the nine months ended December 31, 2003 and 2002, respectively. For the nine months ended December 31, 2003, funds were used to purchase marketable securities of $44.6 million. For the nine months ended December 31, 2003 and 2002, funds were used to purchase property and equipment of $610,000 and $621,000, respectively. In December 2003, we purchased a software product used primarily for modeling voice communications for approximately $179,000.

Cash provided by financing activities was $2.4 million and $742,000 for the nine months ended December 31, 2003 and 2002, respectively. Cash provided by financing activities reflects the proceeds received from the exercise of stock options and the sale of common stock under our 2000 Employee Stock Purchase Plan.

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As discussed in Note 5 to our condensed consolidated financial statements, we have a credit facility with a commercial bank for borrowings up to $10.0 million, which expires in June 2004. Borrowings under this line of credit bear interest at an annual rate equal to LIBOR plus 2% to 2.5%. We have currently used $2.8 million of this facility for a letter of credit that secures the lease for our headquarters in Bethesda, Maryland. We had no outstanding borrowings under this line of credit facility as of December 31, 2003, and available borrowings at that date were $2.9 million.

As of December 31, 2003, our contractual commitments include operating leases for office facilities, notes payable in the amount of $300,000, and a letter of credit in the amount of $2.8 million.

We expect working capital needs to increase in the foreseeable future in order for us to execute our business plan. We anticipate that operating activities, as well as planned capital expenditures, will constitute a material use of our cash resources. In addition, we may utilize cash resources to fund acquisitions or investments in complementary businesses, technologies or products.

We believe that our current cash and cash equivalents and cash generated from operations, along with available borrowings under our line of credit facility, will be sufficient to meet our anticipated cash requirements for working capital and capital expenditures for at least the next 12 months.

New Accounting Pronouncements

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Interpretation No. 45 requires a guarantor to include disclosure of certain obligations, and if applicable, at the inception of the guarantee, recognize a liability for the fair value of certain other obligations undertaken in issuing a guarantee. The recognition requirement was effective for guarantees issued or modified after December 31, 2002. We adopted Interpretation No. 45 effective December 2002 and the applicable disclosures have been made.

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Issue 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of Issue 00-21 apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003 but do not supersede existing authoritative guidance, including SOP 97-2. The adoption of Issue 00-21 did not have an impact on our consolidated results of operations or financial position.

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors 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. We adopted the provisions of FIN 46 effective January 1, 2003. We do not have any variable interest entities; thus adoption of FIN 46 did not have an impact on our consolidated results of operations or financial position.

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, Accounting for Derivative Instruments and Hedging. The statement requires that contracts with comparable characteristics be accounted for similarly and clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except in certain circumstances, and for hedging relationships designated after June 30, 2003. We currently do not hedge foreign exchange rate risk, nor have we entered into any derivative instruments or transactions that are subject to SFAS No. 133 or SFAS No. 149. We adopted SFAS No. 149 effective July 1, 2003. The adoption of this standard did not have an effect on our consolidated results of operations or financial position.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. We are not currently a party to any of the types of financial instruments that are subject to SFAS No.150.

Critical Accounting Policies

The preparation of our financial statements in conformity with generally accepted accounting principles requires us to utilize accounting policies and make estimates and assumptions that affect our reported amounts. Future results may differ from these estimates under different assumptions or conditions. We consider the following accounting policies to be both important to the portrayal of our financial position and results of operations and require the exercise of significant, subjective, or complex judgment and/or estimates.

Revenue Recognition. We recognize revenue in accordance with Statement of Position (SOP) No. 97 2, Software Revenue Recognition, as amended by SOP No. 98-9, Modification of SOP No. 97-2, Software Revenue Recognition, With Respect to Certain Transactions, SOP No. 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts and the Securities and Exchange Commission Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements.

For our software arrangements, a determination needs to be made for each arrangement regarding whether the percentage-of-completion contract accounting method should be used to recognize revenue or whether revenue can be recognized when the software is delivered and all of the conditions of SOP 97-2, as amended, are met. Contract accounting is required if our services are essential to the arrangement. In many cases where consulting services are sold with software licenses, our services are essential to the arrangement because they involve customization and enhancements, and our fees are paid in stages based upon the completion of defined service deliverables. As a result, we typically recognize revenue from these arrangements using contract accounting, which generally results in recording revenue over a longer period of time. In other cases, our services are not essential to the arrangement and the realization of our license fee is not dependent on the completion of such services. In these situations, we recognize software license revenue when (1) persuasive evidence of an arrangement exists, (2) the product has been delivered, (3) the fee is fixed or determinable, and (4) collectibility is probable, which generally results in recording revenue earlier than when contract accounting is used. The determination of whether our services are essential involves significant judgment and could have a material impact on our results of operations from period to period to the extent that significant new arrangements are not accounted for using contract accounting.

Under the percentage-of-completion contract accounting method, we recognize revenue from the entire arrangement based on the percentage of hours actually incurred related to our services at any given time, compared to the total hours we estimate will be required to perform such services. Using the percentage-of-completion method requires us to make estimates about the future cost of services and estimated hours to complete, which are subject to change for a variety of internal and external factors. A change in these estimates could result in a material adjustment to the amount of revenue recorded in any period under the arrangement.

Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts receivable for estimated losses resulting from the inability of our customers to make required payments and for the limited circumstances when the customer disputes the amounts due us. Our methodology for determining this allowance requires significant estimates. In estimating the allowance, we consider the age of the receivable, the creditworthiness of the customer, the economic conditions of the customer s industry and general economic conditions. While we believe that the estimates we use are reasonable, should any of these factors change; our estimates will also change, which could affect the amount of our future allowance for doubtful accounts as well as future operating income. Specifically, if the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments to us, additional allowances could be required. As of December 31, 2003, accounts receivable totaled $9.0 million, net of an allowance for doubtful accounts of $349,000.

Valuation of Intangible Assets and Goodwill. We account for our goodwill and intangible assets in accordance with SFAS No. 141, Business Combinations and SFAS No. 142, Goodwill and Other Intangible Assets. Our intangible assets consist of acquired technology related to our acquisitions of NetMaker in March 2001, WDM NetDesign in January 2002, and a software product for modeling voice communications in December 2003. They are recorded at cost and amortized on a straight-line basis over their expected useful lives of five years. We use the projected discounted cash flow method in valuing our acquired technology, using certain assumptions including revenue growth, cost levels, present value discount rate and working capital

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requirements. While we believe the assumptions used are reasonable, actual results will likely differ from those assumptions. Future cash flows are subject to change for a variety of internal and external factors. We will periodically review the value of acquired technology for recoverability. Changes in our assumptions at the time of future periodic reviews could result in impairment losses. As of December 31, 2003, intangible assets totaled $1.4 million, net of accumulated amortization of $1.3 million. No impairment losses have been recorded to date.

Goodwill is recorded when the consideration paid for acquisitions exceeds the fair value of net tangible and intangible assets acquired. Goodwill is not amortized. We perform an annual review during our fourth quarter to identify any facts or circumstances that indicate the carrying value of goodwill is impaired. The review is based on various analyses including cash flow and profitability projections and the market capitalization of our common stock. Impairment, if any, is based on the excess of the carrying amount of goodwill over its fair value. As of December 31, 2003, we had goodwill of $12.2 million. No impairment has been indicated to date.

Accounting for Software Development Costs. Costs incurred in the research and development of new software products are expensed as incurred until technological feasibility is established. Development costs are capitalized beginning when a product s technological feasibility has been established and ending when the product is available for general release to our customers. Technological feasibility is reached when the product reaches the working model stage. To date, products and enhancements have generally reached technological feasibility and have been released for sale at substantially the same time and all research and development costs have been expensed. Consequently, no software development costs were capitalized for the three and nine months ended December 31, 2003 and 2002.

Certain Factors That May Affect Future Results

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this report and presented elsewhere by management from time to time.

Our operating results may fluctuate significantly as a result of factors outside of our control, which could cause the market price of our stock to decline.

Our operating results have fluctuated in the past, and are likely to fluctuate significantly in the future. Our financial results may as a consequence fall short of the expectations of public market analysts or investors, which could cause the price of our common stock to decline. Our revenues and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are beyond our control. Factors that could affect our operating results include:

- the timing of large orders;
- changes in the proportion of software arrangements requiring contract accounting;
- changes in the mix of our sales, including the mix between higher margin software products and lower margin services and maintenance, and the proportion of our license sales requiring us to make royalty payments;
- the timing and amount of our marketing, sales, and product development expenses;

the cost and time required to develop new software products;

the introduction, timing, and market acceptance of new products introduced by us or our competitors;

changes in network technology or in applications, which could require us to modify our products or develop new products;

general economic conditions, which can affect our customers purchasing decisions, the length of our sales cycle, and our customers ability to pay us on time, if at all;

changes in our pricing policies or those of our competitors; and

the timing and size of potential acquisitions by us.

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We expect to make significant expenditures in all areas of our business, particularly sales and marketing operations, in order to promote future growth. Because the expenses associated with these activities are relatively fixed in the short term, we may be unable to adjust spending quickly enough to offset any unexpected shortfall in revenue growth or any decrease in revenue levels. In addition, our revenues in any quarter depend substantially on orders we receive and ship in that quarter. We typically receive a significant portion of orders in any quarter during the last month of the quarter, and we cannot predict whether those orders will be placed and shipped in that period. If we have lower revenues than we expect, we probably will not be able to reduce our operating expenses quickly in response. Therefore, any significant shortfall in revenues or delay of customer orders could have an immediate adverse effect on our operating results in that quarter.

For all of these reasons, quarterly comparisons of our financial results are not necessarily meaningful and you should not rely on them as an indication of our future performance.

The market for intelligent network management software is new and evolving, and if this market does not develop as anticipated, our revenues could decline.

We derive all of our revenues from the sale of products and services that are designed to allow our customers to manage the performance of networks and applications. Accordingly, if the market for intelligent network management software does not continue to grow, we could face declining revenues, which could ultimately lead to our becoming unprofitable. The market for intelligent network management software solutions is in an early stage of development. Therefore, we cannot accurately assess the size of the market and may be unable to identify an effective distribution strategy, the competitive environment that will develop, and the appropriate features and prices for products to address the market. If we are to be successful, our current and potential customers must recognize the value of intelligent network management software solutions, decide to invest in the management of their networks, and, in particular, adopt and continue to use our software solutions.

Our customers are primarily in four target groups and our operating results may be adversely affected by changes in one or more of these groups.

Our software solutions and services are designed to meet the needs of enterprises, U.S. government agencies, service providers, and network equipment manufacturers, and we market our solutions and services to those four customer groups. Consequently, our financial results depend, in significant part, upon the economic conditions of enterprises, U.S. government agencies, service providers, and network equipment manufacturers. An economic downturn or adverse change in the regulatory environment or business prospects for one or more of these customer groups may decrease our revenues or lower our growth rate.

The U.S. Department of Defense may not extend one consulting contract with us, which could harm our business.

In January 2003, we were awarded a consulting contract with the U.S. Department of Defense. The funding under this contract for calendar year 2003 was $3.1 million, and there are four successive option years under the contract that may be exercised by the U.S. Department of Defense in its discretion. In January 2004, U.S. Department of Defense exercised the first of four possible contract extensions. The funding under this contract for calendar year 2004 is $3.5 million Our results of operations could be adversely affected if any of the remaining option are not exercised, or the contract otherwise does not receive additional funding.

A decline in information technology spending may result in a decrease in our revenues or lower our growth rate.

A decline in the demand for information technology among our current and prospective customers may result in decreased revenues or a lower growth rate for us because our sales depend, in part, on our customers budgets for new or additional information technology systems and services. A continued economic downturn may cause our customers to reduce or eliminate information technology spending and force us to lower prices of our solutions, which would substantially reduce the number of new software licenses we sell and the average sales price for these licenses. Accordingly, we cannot assure you that we will be able to increase or maintain our revenues.

Our sales to U.S. government agencies subject us to special risks that could adversely affect our business.

We derive a substantial portion of our revenues from sales directly or indirectly to U.S. government agencies. Transactions with U.S. government agencies accounted for approximately 46% and 34% of our total revenues for the three months ended December 31, 2003 and 2002, respectively, and accounted for approximately 46% and 38% of our total revenues for the nine months ended December 31, 2003 and 2002, respectively. Government sales entail a variety of risks including:

Government contracts are subject to the approval of appropriations by the U.S. Congress to fund the expenditures by the agencies under these contracts. Congress often appropriates funds for government agencies on a yearly basis, even though their contracts may call for performance over a number of years.

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A significant decline in government expenditures generally, or a shift in budget priorities away from agencies or programs that we support, could cause a material decline in our government business. In particular, a decline in government spending on information technology or related services could hurt our government business.

Our products and services are included on a General Services Administration (GSA) schedule. We believe that the GSA schedule facilitates our sales to U.S. government agencies. The loss of the GSA schedule covering our products and services could adversely affect our results of operations.

We must comply with complex federal procurement laws and regulations in connection with government contracts, which may impose added costs on our business.

Some of our government business requires that we maintain facility security clearances, and requires some of our employees to maintain individual security clearances. If we were to lose these clearances, our government business might decline.

The federal government audits and reviews the performance of federal contractors on contracts, pricing practices, cost structure, and compliance with applicable laws, regulations, and standards. An audit of our work could result in a finding that we overcharged the government, which could result in an adjustment to our previously reported operating results. If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with U.S. federal government agencies.

Many of our government contracts are firm fixed-price contracts. To the extent that the assumptions we have used in pricing these contracts prove inaccurate, we could incur losses on contracts, which would adversely affect our operating results.

A portion of our sales to the U.S. government are made indirectly as a subcontractor to another government contractor, referred to as the prime contractor, who has the direct relationship with the government. We also team with prime contractors to bid on competitive government opportunities for which we hope to serve as a subcontractor. If prime contractors lose existing business on which we serve as a subcontractor, or fail to win the competitive bids on which we team with them, our government business would be hurt.

We could face expense and delay if any or our competitors, or competitors of the prime contractors to which we serve as a subcontractor, protest or challenge contract awards made to us or our prime contractors pursuant to competitive bidding.

Federal government contracts contain provisions and are subject to laws and regulations that provide government clients with rights and remedies not typically found in commercial contracts. These rights and remedies allow government clients, among other things, to terminate existing contracts, with short notice, for convenience without cause; reduce or modify contracts or subcontracts; and claim rights in products, systems, and technology produced by us.

If our newest products, particularly those targeted primarily for enterprises and U.S. government agencies, do not gain widespread market acceptance, our revenues might not increase and could even decline.

We expect to derive a substantial portion of our revenues in the future from sales to enterprises and U.S. government agencies of version 10.0 of *OPNET IT Guru,* which was released in August 2003, and its associated modules including *Application Characterization Environment*, *ACE Decode Module*, *NetDoctor* and *Flow Analysis*s, and *OPNET VNE Server*, which was released in June 2002. Our business depends on customer acceptance of these products and our revenues may not increase, or may even decline, if our target customers do not adopt and expand their use of our products. In addition, if our

OPNET Modeler product, which we have been selling since 1987, continues to encounter declining sales, which could occur for a variety of reasons, including market saturation and the financial condition of network equipment manufacturers, and sales of our newer products do not grow at a rate sufficient to offset the shortfall, our revenues would decline.

We may not be able to grow our business if service providers do not buy our products.

An element of our strategy is to increase sales to service providers of *OPNET SP Guru* and *OPNET WDM Guru*, both launched in fiscal 2002, and *OPNET VNE Server*, which was launched in fiscal 2003. Accordingly, if our products fail to perform favorably in the service provider environment, or fail to gain wider adoption by service providers, our business and future operating results could suffer.

Our lengthy and variable sales cycle makes it difficult to predict operating results.

It is difficult for us to forecast the timing and recognition of revenues from sales of our products because prospective customers often take significant time evaluating our products before licensing them. The period between initial customer contact and a purchase by a customer may vary from three months to more than a year. During the sales process, the customer may decide not to purchase or may reduce proposed orders of our products for various reasons, including changes in budgets and purchasing priorities. Our prospective customers routinely require education regarding the use and benefit of our products. This may also lead to delays in receiving customers orders.

If we do not successfully expand our sales force, we may be unable to increase our sales.

We sell our products primarily through our direct sales force, and we must expand the size of our sales force to increase revenues. If we are unable to hire or retain qualified sales personnel, if newly hired personnel fail to develop the necessary skills to be productive, or if they reach productivity more slowly than anticipated, our ability to increase our revenues and grow our business could be compromised. Our sales people require a long period of time to become productive, typically three to nine months. The time required to reach productivity, as well as the challenge of attracting, training, and retaining qualified candidates, may make it difficult to meet our sales force growth targets. Further, we may not generate sufficient sales to offset the increased expense resulting from growing our sales force, or we may be unable to manage a larger sales force.

Our ability to increase our sales will be impaired if we do not expand and manage our indirect distribution channels.

To increase our sales, we must, among other things, further expand and manage our indirect distribution channels, which consist primarily of international distributors and original equipment manufacturers and resellers. If we are unable to expand and manage our relationships with our distributors, our distributors are unable or unwilling to market and sell our products effectively, or we lose existing distributor relationships, we might not be able to increase our revenues. Our international distributors and original equipment manufacturers and resellers have no obligation to market or purchase our products. In addition, they could partner with our competitors, bundle or resell competitors products, or internally develop products that compete with our products.

We may not be able to successfully manage our expanding operations, which could impair our ability to operate profitably.

We may be unable to operate our business profitably if we fail to manage our growth. Our rapid growth has sometimes strained, and may in the future continue to strain, our managerial, administrative, operational, and financial resources and controls. We plan to continue to expand our operations and increase the number of our full-time employees. Our ability to manage growth will depend in part on our ability to continue to enhance our operating, financial, and management information systems. Our personnel, systems, and controls may not be adequate to support our growth. In addition, our revenues may not continue to grow at a sufficient rate to absorb the costs associated with a larger overall employee base.

If we are unable to introduce new and enhanced products on a timely basis that respond effectively to changing technology, our revenues may decline.

Our market is characterized by rapid technological change, changes in customer requirements, frequent new product and service introductions and enhancements, and evolving industry standards. If we fail to develop and introduce new and enhanced products on a timely basis that respond to these changes, our products could become obsolete, demand for our products could

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decline and our revenues could fall. Advances in network management technology, software engineering, and simulation technology, or the emergence of new industry standards, could lead to new competitive products that have better performance, more features, or lower prices than our products and could render our products unmarketable.

Our future revenues are substantially dependent upon our existing customers continuing to license additional products, renew maintenance agreements and purchase additional services.

Our existing customers have traditionally generated additional revenues from consulting services, renewed maintenance agreements and purchase of additional software licenses, which represents a majority of our annual revenues. The maintenance agreements are generally renewable at the option of the customers and there are no mandatory payment obligations or obligations to license additional software. In addition, customers may decide not to purchase additional products or services. If our existing customers fail to renew their maintenance agreements or purchase additional products or services, our revenues could decrease.

Increases in professional service revenues as a percentage of total revenues could decrease overall margins.

We realize lower margins on professional service revenues than we do on other types of revenues. As a result, if professional service revenues increase as a proportion of total revenues, our gross margins will be lower.

If we fail to retain our key personnel and attract and retain additional qualified personnel, we might not be able to maintain our current level of revenues.

Our future success and our ability to maintain our current level of revenues depend upon the continued service of our executive officers and other key sales and research and development personnel. The loss of any of our key employees, in particular Marc A. Cohen, our chairman of the board and chief executive officer, and Alain J. Cohen, our president and chief technology officer, could also adversely affect our ability to pursue our growth strategy. We do not have employment agreements or any other agreements that obligate any of our officers or key employees to remain with us.

We must also continue to hire highly qualified individuals, particularly software engineers and sales and marketing personnel. Our failure to attract and retain technical personnel for our product development, consulting services, and technical support teams may limit our ability to develop new products or product enhancements. Competition for these individuals is intense, and we may not be able to attract and retain additional highly qualified personnel in the future. In addition, limitations imposed by federal immigration laws and the availability of visas could impair our ability to recruit and employ skilled technical professionals from other countries to work in the United States.

Our international operations subject our business to additional risks, which could cause our sales or profitability to decline.

We plan to increase our international sales activities, but these plans are subject to a number of risks that could cause our sales to decline or could otherwise cause a decline in profitability. These risks include:

difficulty in attracting distributors that will market and support our products effectively;

greater difficulty in accounts receivable collection and longer collection periods;

the need to comply with varying employment policies and regulations that could make it more difficult and expensive to manage our employees if we need to establish more direct sales or support staff outside the United States;

potentially adverse tax consequences;

the effects of currency fluctuations; and

political and economic instability.

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We expect to face increased competition, which could cause us to lose sales, resulting in lower profitability.

Increasing competition in our market could cause us to lose sales and become unprofitable. We believe that the market for intelligent network management software is likely to become more competitive as it evolves and the demand for intelligent network management solutions continues to increase. At least one of our current competitors and many of our potential competitors are larger and have substantially greater financial and technical resources than we do. In addition, it is possible that other vendors as well as some of our customers or distributors will develop and market solutions that compete with our products in the future.

If our products contain errors and we are unable to correct those errors, our reputation could be harmed and our customers could demand refunds from us or assert claims for damages against us.

Our software products could contain significant errors or bugs that may result in:

- the loss of or delay in market acceptance and sales of our products;
- the delay in introduction of new products or updates to existing products;
- diversion of our resources;
- injury to our reputation; and
- increased support costs.

Bugs may be discovered at any point in a product s life cycle. We expect that errors in our products will be found in the future, particularly in new product offerings and new releases of our current products.

Because our customers use our products to manage networks that are critical to their business operations, any failure of our products could expose us to product liability claims. In addition, errors in our products could cause our customers networks and systems to fail or compromise their data, which could also result in liability to us. Product liability claims brought against us could divert the attention of management and key personnel, could be expensive to defend, and may result in adverse settlements and judgments.

Our software products rely on our intellectual property, and any failure to protect our intellectual property could enable our competitors to market products with similar features that may reduce our revenues and could allow the use of our products by users who have not paid the required license fee.

If we are unable to protect our intellectual property, our competitors could use our intellectual property to market products similar to our products, which could reduce our revenues. In addition, we may be unable to prevent the use of our products by persons who have not paid the required license fee, which could reduce our revenues. Our success and ability to compete depend substantially upon the internally developed technology that is incorporated in our products. Policing unauthorized use of our products is difficult, and we may not be able to prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as those in the United States. Others may circumvent the patents, copyrights, and trade secrets we own. In the ordinary course of business, we enter into a combination of confidentiality, non-competition and non-disclosure agreements with our employees.

These measures afford only limited protection and may be inadequate, especially because our employees are highly sought after and may leave our employ with significant knowledge of our proprietary information. In addition, any confidentiality, non-competition and non-disclosure agreements we enter into may be found to be unenforceable, or our copy protection mechanisms embedded in our software products could fail or could be circumvented.

Our products employ technology that may infringe on the proprietary rights of others, and, as a result, we could become liable for significant damages.

We expect that our software products may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionalities of products in different industry segments overlap.

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Regardless of whether these claims have any merit, they could:

- be time-consuming to defend;
- result in costly litigation;
- divert our management s attention and resources;
- cause us to cease or delay product shipments; or
- require us to enter into royalty or licensing agreements.

These royalty or licensing agreements may not be available on terms acceptable to us, if at all. A successful claim of product infringement against us or our failure or inability to license the infringed or similar technology could adversely affect our business because we would not be able to sell the affected product without redeveloping it or incurring significant additional expense.

Future interpretations of existing accounting standards could adversely affect our operating results.

The American Institute of Certified Public Accountants and its Software Revenue Recognition Task Force continue to issue interpretations and guidance for applying the relevant standards to a wide range of sales contract terms and business arrangements that are prevalent in the software industry. Future interpretations of existing accounting standards or changes in our business practices could result in future changes in our revenue recognition accounting policies that could have a material adverse effect on our results of operations.

As with other software vendors, we may be required to delay revenue recognition into future periods, which could adversely affect our operating results.

We have in the past had to, and in the future may have to, defer recognition for license fees due to several factors, including whether:

- software arrangements include undelivered elements for which we do not have vendor specific evidence of fair value;
- we must deliver services for significant customization, enhancements and modifications of our software;
- the transaction involves material acceptance criteria or there are other identified product-related issues;
- the transaction involves contingent payment terms or fees;

we are required to accept a fixed-fee services contract; or

we are required to accept extended payment terms.

Because of the factors listed above and other specific requirements under accounting principles generally accepted in the United States of America for software revenue recognition, we must have very precise terms in our software arrangements in order to recognize revenue when we initially deliver software or perform services. Negotiation of mutually acceptable terms and conditions can extend the sales cycle, and sometimes we do not obtain terms and conditions that permit revenue recognition at the time of delivery.

If we undertake acquisitions, they may be expensive and disruptive to our business and could cause the market price of our common stock to decline.

We completed the NetMaker and WDM NetDesign acquisition in March 2001 and January 2002, respectively. We may continue to acquire or make investments in companies, products or technologies if opportunities arise. Any acquisition could be expensive, disrupt our ongoing business, distract our management and employees, and adversely affect our financial results and the market price of our common stock. We may not be able to identify suitable acquisition or investment candidates, and if we do identify suitable candidates, we may not be able to make these acquisitions or investments on commercially acceptable terms or at all. If we make an acquisition, we could have difficulty integrating the acquired technology, employees, or operations. In addition, the key personnel of the acquired company may decide not to work for us.

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We also expect that we would incur substantial expenses if we acquired other businesses or technologies. We might use cash on hand, incur debt, or issue equity securities to pay for any future acquisitions. If we issue additional equity securities, our stockholders could experience dilution and the market price of our stock may decline.

Our products are subject to changing computing environments, including operating system software and hardware platforms, which could render our products obsolete.

The evolution of existing computing environments and the introduction of new popular computing environments may require us to redesign our products or develop new products. Computing environments, including operating system software and hardware platforms, are complex and change rapidly. Our products are designed to operate in currently popular computing environments. Due to the long development and testing periods required to adapt our products to new or modified computing environments, our research and development efforts could be distracted and we could experience significant delays in product releases or shipments, which could result in lost revenues and significant additional expense.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We consider all highly liquid investments purchased with a maturity of three months or less to be cash equivalents, and those with maturities greater than three months are considered to be marketable securities. Cash equivalents and marketable securities consist primarily of investment grade securities with high credit ratings of relatively short duration that trade in highly liquid markets. Accordingly, we have no quantitative information concerning the market risks and believe that the risk is minimal. Our outstanding notes payable have fixed interest rates and their carrying values approximate fair value. We currently do not hedge interest rate exposure, but do not believe that an increase in interest rates would have a material effect on the value of our cash equivalents, marketable securities or notes payable.

At December 31, 2003, we had $33.9 million in cash and cash equivalents and $44.6 million in marketable securities. Based on our cash, cash equivalents, and marketable securities as of December 31, 2003, a hypothetical 10% increase/decrease in the interest rates would increase/decrease our annual interest income and cash flows by approximately $70,000.

A majority of our revenue transactions outside the United States are denominated in U.S. dollars. The operating expenses of our foreign subsidiaries are denominated in local currencies. We currently do not hedge foreign exchange rate risk. Due to the limited nature of our foreign operations, we do not believe that a 5% change in exchange rates would have a material effect on our business, financial condition, or results of operations.

ITEM 4. CONTROLS AND PROCEDURES

We maintain a system of internal controls and procedures that are designed to provide reasonable assurance that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2003, and have each concluded that, as of the evaluation date, such controls and procedures were effective, in all material respects, to ensure that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

During the three months ended December 31, 2003, there have been no changes to our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Subsequent to the date of the evaluation, there have been no significant changes to our internal controls or in other factors that could significantly affect our internal controls.

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PART II. OTHER INFORMATION

ITEM 1. ***Legal Proceedings***

OPNET is involved in various claims and legal proceedings arising from its normal operations. Management does not consider any of those matters to be material.

ITEM 2. ***Changes in Securities and Use of Proceeds***

In August 2000, we closed an initial public offering of our common stock. The Registration Statement on Form S-1 (No. 333-32588) was declared effective by the Securities and Exchange Commission on August 1, 2000 and we commenced the offering on that date. After deducting the underwriting discounts and commissions and the offering expenses, the net proceeds from the offering were approximately $54.1 million.

As of December 31, 2003, the proceeds from the offering have been used to fund approximately (i) $7.6 million of general corporate expenses, working capital and capital expenditures, including $4.8 million for capital expenditures and leasehold improvements related to our headquarters facility in Bethesda, MD, (ii) $6.2 million of acquisition and acquisition-related expenses for the NetMaker acquisition, and (iii) $1.4 million of the purchase price for WDM NetDesign. None of these amounts were paid directly or indirectly to any director, officer, or general partner of us or their associates, persons owning 10% or more of any class of our equity securities, or any affiliate of us. We have not allocated any of the remaining net proceeds to any identifiable uses. We may also use a portion of the net proceeds to acquire businesses, products, or technologies that are complementary to our business. Pending their use, we have invested the net proceeds in investment grade, interest-bearing securities.

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

At the Annual Meeting of Stockholders of the Company held on November 18, 2003, (i) the Company s nominees for Class III Directors for the ensuing three years were elected and the selection of Deloitte & Touche LLP as the Company s independent auditor s for the current fiscal year was ratified.

With respect to the election of the Class III Directors, the voting was as follows:

Nominees	For	Withheld
Marc A. Cohen	14,575,080	4,312,708
William F. Stasior	18,450,043	437,745

With respect to the ratification of the selection of Deloitte & Touche LLP as the Company s independent auditors for the current fiscal year, the voting was as follows:

For	18,545,518
Against	309,562
Abstain	32,708

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

A. Exhibits: See Exhibit Index
B. Reports on Form 8-K

Current report on Form 8-K furnished to the SEC on January 28, 2004, furnished information under Item 7. Financial Statements, Pro Forma Financial Information and Exhibits and Item 12. Disclosure of Operations and Financial Condition of Form 8-K

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SIGNATURE

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

	OPNET TECHNOLOGIES, INC. (Registrant)	
	By:	/s/ Joseph W. Kuhn
Date: January 29, 2004	Name:	Joseph W. Kuhn
	Title:	Vice President of Finance and Chief Financial Officer
		(Principal Financial and Accounting Officer)

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OPNET TECHNOLOGIES, INC.

EXHIBIT INDEX

Exhibit Number	Description	Source
3.1	Third Amended and Restated Certificate of Incorporation of the Registrant	Incorporated by reference from exhibit 3.2 to the Registrant s Registration Statement on Form S-1 (File No. 333-2588).
3.2	Amended and Restated By-Laws of the Registrant	Incorporated by reference from exhibit 3.4 to the Registrant s Registration Statement on Form S-1 (File No. 333-2588).
4.1	Specimen common stock certificate	Incorporated by reference from exhibit 4.1 to the Registrant s Registration Statement on Form S-1 (File No. 333-2588).
4.2	See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and By-Laws of the Registrant defining the rights of holders of common stock of the Registrant	Incorporated by reference from exhibit 4.2 to the Registrant s Registration Statement on Form S-1 (File No. 333-2588).
*31.1	Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended	Exhibit 31.1 to this Quarterly Report on Form 10-Q.
*31.2	Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended	Exhibit 31.2 to this Quarterly Report on Form 10-Q.
*32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Exhibit 32.1 to this Quarterly Report on Form 10-Q.
*32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Exhibit 32.2 to this Quarterly Report on Form 10-Q.

* filed herewith

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cal-align: top; background-color: rgb(204,238,255)">2.3 Form of Voting and Exchange Trust Agreement, dated February 8, 2013, by and among SimplePons, Inc., Eco-Shift Call Corp., Eco-Shift Acquisition Corp. and Patriquin Law Professional Corporation (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 2.4 Form of Rollover Agreement, dated February 8, 2013, by and between SimplePons, Inc. and each of Frank Yapuncic, Gilbert Wood, James Hughes, Jeff Preitauer, Patty Bates-Wood and certain other individuals, respectively (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 2.5 Form of Support Agreement, dated February 8, 2013, by and among SimplePons, Inc., Eco-Shift Call Corp. and Eco-Shift Acquisition Corp. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 3.1 Amended and Restated Certificate of Incorporation of Paligent Inc. (f/k/a HeavenlyDoor.com, Inc.), filed with the Secretary of State of Delaware on June 26, 2000 (Incorporated by reference to the registrant's registration statement on Form S-8 (Commission File No. 333-45168) filed on September 5, 2000). 3.2 Certificate of Ownership and Merger of Paligent Inc. into HeavenlyDoor.com, Inc., filed with the Secretary of State of Delaware on December 28, 2000, to be effective as of December 31, 2000. (Incorporated by reference to the registrant's Annual Report on Form 10-K for the year ended December 31, 2000, filed on April 2, 2001). 3.3 Certificate of Amendment to Certificate of Incorporation of Paligent Inc. filed with the Secretary of State of the State of Delaware on November 28, 2006, to be effective as of November 29, 2006 to give effect to the reverse stock split (Incorporated by reference to the registrant's Current Report on Form 8-K filed on December 5, 2006). 3.4 Certificate of Amendment to Certificate of Incorporation of Paligent Inc. filed with the Secretary of State of the State of Delaware on November 28, 2006, to be effective as of November 29, 2006 to change the Registrant's name to International Fight League, Inc. (Incorporated by reference to the registrant's Current Report on Form 8-K filed on December 5, 2006). 3.5 Certificate of Amendment to the registrant's Amended and Restated Certificate of Incorporation, filed with the Secretary of State of Delaware on June 28, 2007 (Incorporated by reference to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 filed on August 14, 2007). 3.6 Amended and Restated By-laws of the Company (Incorporated by reference to the registrant's Current Report on Form 8-K filed on May 22, 2007). 3.7 Certificate of Amendment to the registrant's Amended and Restated Certificate of Incorporation, filed with the Secretary of State of Delaware and effective on July 8, 2010 (Incorporated by reference to the registrant's Current Report on Form 8-K filed July 12, 2010). 3.8 Certificate of Merger (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 7, 2011). 3.9 Amendment No. 1 dated November 1, 2011 to the Amended and Restated Bylaws (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 7, 2011). 3.10 Certificate of Amendment to the Amended and Restated Certificate of Incorporation (Incorporated by reference to the registrant's Current Report on Form 8-K filed on December 15, 2011). 3.11 Certificate of Incorporation of Eco-Shift Call Corp. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 3.12 Certificate of Incorporation of Eco-Shift Acquisition Corp. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 3.13 Certificate of Incorporation of Eco-Shift Power Corp. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 3.14 Bylaws of Eco-Shift Call Corp. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 3.15 Bylaws of Eco-Shift Acquisition Corp. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 3.16 Bylaws of Eco-Shift Power Corp. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 3.17 Certificate of Designation for Series B Preferred Stock (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 4.1 Form of Warrant dated August 6, 2007 (Incorporated by reference to the registrant's Current Report on Form 8-K filed on August 9, 2007). 4.2 Warrant dated March 1, 2007 issued to placement agent (Incorporated by reference to the registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, filed on May 15, 2007). 4.3 Warrant dated August 6, 2007 issued to placement agent (Incorporated by reference to the registrant's registration statement on Form S-1 (Commission File No. 333-146629) filed October 11, 2007). 4.4 Warrant dated June 1, 2007 issued to consultant (Incorporated by reference to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007, filed on August 14, 2007). 4.5 Form of Coach's Warrant (Incorporated by reference to the registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007, filed on August 14, 2007). 4.6 Form of Exchange Warrant (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 7, 2011). 4.7 Form of Series B common stock purchase warrant (Incorporated by reference to the Company's Annual Report on Form 10-K filed March 28, 2012). 4.8 Form of Series C common stock purchase warrant (Incorporated by reference to the Company's Annual Report on Form 10-K filed March 28, 2012). 4.9 Form of Placement Agent Warrant (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed May 14, 2012). 4.10 Form of Series D common stock purchase warrant (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed August 17, 2012). 4.11 Convertible Promissory Note dated October 26, 2012 in the principal amount of $63,000 due to Asher Enterprises, Inc. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed November 27, 2012). 4.12 Convertible Promissory Note, dated October 26, 2012, issued by SimplePons, Inc. in favor of Asher Enterprises, Inc. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 10.1 Asset Purchase Agreement, dated September 19, 2008, between IFL Corp. and HD Net LLC (Incorporated by reference to the Current Report on Form 8-K filed by the registrant on September 24, 2008). 10.2 Registration Rights Agreement, dated December 22, 2006 between International Fight League, Inc. and the stockholders party thereto (Incorporated by reference to the registrant's registration statement on Form S-1 (Commission File No. 333-140636) filed on February 12, 2007). 10.3 Stock Repurchase Agreement dated November

1, 2011 by and between IFLI Acquisition Corp., Insurance Marketing Solutions, LLC and SimplePons, Inc.(Incorporated by reference to the registrant's Current Report on Form 8-K filed November 7, 2011). 10.4 Employment Agreement dated February 15, 2011 by and among SimplePons, Inc. and Brian S. John (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 17, 2011). 10.5 Employment Agreement dated February 15, 2011 by and among SimplePons, Inc. and Richard A. Miller (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 17, 2011). 10.6 Employment Agreement dated February 15, 2011 by and among SimplePons, Inc. and Martin Scott (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 17, 2011). 10.7 Employment Agreement dated February 15, 2011 by and among SimplePons, Inc. and Wei-Ken Seto (Incorporated by reference to the registrant's Current Report on Form 8-K filed January 26, 2012). 10.8 Office Lease Agreement dated November 11, 2011 by and among ATC Realty One, LLC and SimplePons, Inc.(Incorporated by reference to the registrant's Current Report on Form 8-K filed November 17, 2011). 10.9 2011 Equity Compensation Plan (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 7, 2011). 10.10 Form of Registration Rights Agreement (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed May 14, 2012). 10.11 Advisory Agreement dated July 23, 2012 by and between SimplePons, Inc. and Adolfo Carmona (Incorporated by reference to the registrant's Current Report on Form 8-K filed August 3, 2012). 10.12 Investor Relations Agreement dated June 26, 2012 by and between SimplePons, Inc. and American Capital Ventures, Inc. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed August 17, 2012). 10.13 Investor Relations and Consulting Agreement dated August 6, 2012 by and between SimplePons, Inc. and Acorn Management Partners, L.L.C. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed August 17, 2012). 10.14 Advisory Agreement dated August 1, 2012 by and between SimplePons, Inc. and Dr. David Greenfield (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed August 17, 2012). 10.15 Securities Purchase Agreement dated October 26, 2012 by and between SimplePons, Inc. and Asher Enterprises, Inc. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed November 27, 2012). 10.16 Agreement dated October 26, 2012 by and between Greentree Financial Group, Inc. and SimplePons, Inc. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed November 27, 2012). 10.17 Assignment Agreement, dated February 8, 2013, by and among Asher Enterprises, Inc., Linear Capital LLC and SimplePons, Inc. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 10.18 Modification of Convertible Promissory Note, dated February 8, 2013, executed by SimplePons, Inc. and Linear Group Holdings, Inc. (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 14.1 Code Business Conduct and Ethics adopted November 1, 2011 (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 7, 2011). 16.1 Letter dated November 4, 2011 from Rothstein, Kass & Company, P.C. (Incorporated by reference to the registrant's Current Report on Form 8-K filed November 7, 2011). 16.2 Letter of Liggett, Vogt & Webb, P.A., dated March 11, 2013 (Incorporated by reference to the registrant's Current Report on Form 8-K filed March 12, 2013). 17.1 Resignation Letter of Brian S. John (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 17.2 Resignation Letter of Richard A. Miller (Incorporated by reference to the registrant's Current Report on Form 8-K filed February 14, 2013). 31.1 Certification by the Principal Executive Officer of Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a) or Rule 15d-14(a)) * 31.2 Certification by the Principal Financial Officer of Registrant pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (Rule 13a-14(a) or Rule 15d-14(a))* 32.1 Certification by the Principal Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002* 32.2 Certification by the Principal Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 * 101.INS XBRL Instance Document ** 101.SCH XBRL Taxonomy Extension Schema ** 101.CAL XBRL Taxonomy Extension Calculation Linkbase ** 101.DEF XBRL Taxonomy Extension Definition Linkbase ** 101.LAB XBRL Taxonomy Extension Label Linkbase ** 101.PRE XBRL Taxonomy Extension Presentation Linkbase **

* filed herewith

** In accordance with Regulation S-T, the XBRL-related information on Exhibit No. 101 to this Annual Report on Form 10-K/A shall be deemed “furnished” herewith and not “filed.”

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SIMPLEPONS, INC.

Date: May 10, 2013	By***: /s/ Gilbert Wood***
	Name: Gilbert Wood Title: Chief Executive Officer(Principal Executive Officer)
Date: May 10, 2013	By**:** ***/s/ James Hughes***
	Name: James Hughes Title: Chief Financial Officer(Principal Financial Officer)

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

Name	**Position**	**Date**
/s/ Gilbert Wood Gilbert Wood	Chief Executive Officer, President and Director	May 10, 2013
/s/ James Hughes James Hughes	Chief Financial Officer and Director	May 10, 2013

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of:

SimplePons, Inc.

We have audited the accompanying consolidated balance sheet of SimplePons, Inc. and Subsidiary (the "Company") as of December 31, 2012 and the related consolidated statement of operations, changes in stockholders' deficit and cash flows for the year ended December 31, 2012 and for the period from February 7, 2011 (Inception) to December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of the Company as of December 31, 2011, and for the period from February 7, 2011 (Inception) to December 31, 2011, were audited by another auditor; whose report dated March 26, 2012; express an unqualified opinion on the financial statements.

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

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of SimplePons, Inc. as of December 31, 2012 and the results of its operations and its cash flows for the year ended December 31, 2012 and for the period from February 7, 2011 (Inception) to December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements the Company has continuing losses and negative cash flows from operations. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans concerning these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ DNTW Toronto LLP

Licensed Public Accountants

Markham, Ontario, Canada

April 15, 2013

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R EPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of: SimplePons, Inc.

W e have audited the accompanying consolidated balance sheet of SimplePons, Inc. and Subsidiary (the "Company") as of December 31, 2011 and the related consolidated statement of operations, changes in stockholders' equity and cash flows for the period from February 7, 2011 (Inception) to December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

I n our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of SimplePons, Inc. as of December 31, 2011 and the results of its operations and its cash flows for the period from February 7, 2011 (Inception) to December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, for the period from February 7, 2011 (Inception) to December 31, 2011, the Company has a net loss of $831,590 and a negative cash flow from operations of $489,045. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans concerning these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/S/ Liggett, Vogt & Webb, P.A.

LIGGETT, OGT & WEBB, P.A.

Certified Public Accountants

Boynton Beach, Florida March 26, 2012

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SIMPLEPONS, INC AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2012 AND 2011

ASSETS

	December 31, 2012	December 31, 2011
CURRENT ASSETS		
Cash	$1,558	$120,768
Accounts receivable, net	1,300	820
Inventory, net	—	28,753
Prepaid expenses and other current assets	1,452	362,138
Deposit	9,283	9,494
TOTAL CURRENTS ASSETS	13,593	521,973
TOTAL PROPERTY AND EQUIPMENT, NET	15,120	12,690
OTHER ASSETS		
Website, net	—	106,311
Prepaid expenses	—	93,750
Trademarks	—	825
TOTAL OTHER ASSETS	—	200,886
TOTAL ASSETS	$28,713	$735,549
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY		
CURRENT LIABILITIES		
Accounts payable	$73,148	$65,591
Accrued liabilities	121,749	
Accrued salaries payable	208,077	92,339
Liquidated damages payable	25,900	—
Contingent liabilities	23,062	—
Convertible note payable	36,449	—
Convertible note payable - related party	40,000	—
Derivative liabilities	63,110	—
TOTAL LIABILITIES	591,495	157,930
COMMITMENTS AND CONTINGENCIES (Note 14)		
STOCKHOLDERS' (DEFICIT) EQUITY		

Preferred stock, $0.0001 par value, 1,000,000 shares authorized, 0 shares issued and outstanding	—	—
Common stock, $0.01 par value, 400,000,000 shares authorized, 87,970,870 and 77,140,870 shares issued and outstanding, respectively	879,709	771,409
Additional paid in capital	1,909,673	637,800
Accumulated deficit	(3,352,164)	(831,590)
TOTAL STOCKHOLDERS' (DEFICIT) EQUITY	(562,782)	577,619
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	$28,713	$735,549

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

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SIMPLEPONS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE YEAR ENDED DECEMBER 31, 2012 AND
FOR THE PERIOD FROM FEBRUARY 7, 2011 (INCEPTION) TO DECEMBER 31, 2011

	For the year ended December 31, 2012	For the Period Ended February 7, 2011 (Inception) to December 31, 2011
Revenue	$120,137	$6,641
Cost of goods sold	68,786	934
Gross Profit	51,351	5,707
OPERATING EXPENSES		
Salaries	843,194	340,405
Consulting	764,544	288,206
Selling, general and administrative	608,708	121,459
Legal and professional	114,376	78,663
Depreciation	39,726	9,078
Total Operating Expenses	2,370,548	837,811
Net loss from operations	(2,319,197)	(832,104)
Other income / (expenses)		
Interest expense	(11,350)	—
Interest income	14	514
Change in fair value of derivative liabilities	(28,011)	—
Liquidated damages	(25,900)	—
Contingent losses	(23,062)	—
Impairment loss from website development	(113,068)	—
Total other expeneses	(201,377)	514
NET LOSS BEFORE PROVISION FOR INCOME TAXES	$(2,520,574)	$(831,590)
PROVISION FOR INCOME TAXES	—	—
NET LOSS	$(2,520,574)	$(831,590)

Net loss per share - basic and diluted	$(0.03)	$(0.01)
Weighted average number of shares outstanding during the period - basic and diluted	81,853,356	59,340,343

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

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SIMPLEPONS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDER'S DEFICIT
FOR THE YEAR ENDED DECEMBER 31, 2012 AND THE PERIOD FROM FEBRUARY 7, 2011 (INCEPTION) TO DECEBMBER 31, 2011

	Preferred stock		Common stock		Additional		
	Shares	Amount	Shares	Amount	paid in capital	Accumulated deficit	Total
February 7 , 2011 (Inception)	-	$-	-	$-	$-	$-	$-
Common stock sold to founders ($.000125)	—	—	40,000,000	400,000	(395,000)	—	5,000
Sale of common stock ($.0025)	—	—	1,000,000	10,000	(7,500)	—	2,500
Sale of common stock ($.00125)	—	—	2,000,000	20,000	(17,500)	—	2,500
Common stock issued for professional fees ($.05 per share)	—	—	1,400,000	14,000	56,000	—	70,000
Private placement of common stock ($.05 per share), net of fees of $11,783	—	—	20,010,000	200,100	788,617	—	988,717
Private placement of common stock ($.25 per share)	—	—	200,000	2,000	48,000	—	50,000
Common stock issued for consulting services ($.05 per share)	—	—	10,000,000	100,000	400,000	—	500,000
Common stock to be issued for Website development ($.05 per share)	—	—	500,000	5,000	20,000	—	25,000
Stock option expense	—	—	—	—	17,183	—	17,183
Reverse Merger	—	—	2,030,870	20,309	(272,000)	—	(251,691)

Net loss for the period February 7, 2011 (Inception) to December 31, 2011	—	—	—	—	—	(831,590)	(831,590)
Balance December 31, 2011	—	—	77,140,870	771,409	637,800	(831,590)	577,619
Common stock issued for cash, net of share issuance costs	—	—	7,580,000	75,800	765,574	—	841,374
Common stock issued for services			3,250,000	32,500	337,500	—	370,000
Stock option expense	—	—	—	—	168,799	—	168,799
Net loss for the year	—	—	—	—	—	(2,520,574)	(2,520,574)
Balance December 31, 2012	—	$ —	87,970,870	$879,709	$ 1,909,673	$(3,352,164)	$(562,782)

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

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SIMPLEPONS, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2012 AND
FOR THE PERIOD FROM FEBRUARY 7, 2011 (INCEPTION) TO DECEMBER 31, 2011

	For the year ended December 31, 2012	For the Period Ended February 7, 2011 (Inception) to December 31, 2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(2,520,574)	$(831,590)
Adjustments to reconcile net loss to net cash provided by / (used in) operating activities:		
Depreciation and amortization expense	39,726	9,079
Impairment of inventory	36,569	—
Impairment of website development	113,068	—
Contingent loss	23,062	—
Amortization of discount on note payable	8,548	
Change in fair value of derivative liabilities	28,011	
Issuance of common stock and warrants for services	688,750	251,250
Issuance of stock options for services	168,799	17,183
Changes in operating assets and liabilities:		
Increase in accounts receivable	(480)	(820)
Increase in inventory	(7,816)	(28,753)
Increase in prepaid expenses and other assets	135,686	(53,830)
Increase in deposits	211	(9,494)
Increase in liquidated damages	25,900	—
Increase in accounts payable and accrued expenses	76,806	72,136
Increase in accrued salaries	115,738	85,794
Net Cash Provided by / (Used In) Operating Activities	(1,067,996)	(489,045)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of trademarks	(650)	(825)
Development of website	(40,820)	(89,612)
Purchase of property and equipment	(6,618)	(13,468)
Net Cash Used In Investing Activities	(48,088)	(103,905)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from Note payable - related party	40,000	—

Proceeds from note payable	63,000	—
Payment pursuant to recapitalization	—	(335,000)
Sale of common stock, net of offering costs	893,874	1,048,718
Net Cash Provided by Investing Activities	996,874	713,718
NET INCREASE / (DECREASE) IN CASH	(119,210)	120,768
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	120,768	—
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$1,558	$120,768
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$—	$—
Cash paid for taxes	$—	$—
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Common stock issued for consulting fees	$370,000	$500,000
Common stock issued for website development	$—	$25,000
Common stock issued for prepaid insurance	$—	$83,308

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

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SIMPLEPONS, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED DECEMBER 31, 2012 AND

THE PERIOD FROM FEBRUARY 7, 2011 (INCEPTION) TO DECEMBER 31, 2011

1. Organization, Basis of Presentation and Nature of Operations

Simplepons, Inc. is a Delaware Corporation formed on February 7, 2011. IFLI Acquisition Corp., formerly International Fight League, Inc. ("IFLI") was incorporated in the State of Delaware on May 8, 1992. On November 1, 2011 we closed on a share exchange agreement with IFLI Acquisition Corp. and exchanged all of our outstanding shares for 37,455,000 shares of IFLI Acquisition Corp, Inc. and warrants equal to and on the same terms as those outstanding at the date of the merger. Simplepons, Inc. was the accounting acquirer and IFLI Acquisition Corp. was the accounting acquiree in the transaction that was treated as a reverse merger and recapitalization. As part of the exchange agreement, IFLI Acquisition Corp. purchased 1,012,353 shares of common stock from the principal stockholder for $335,000 and assumed net assets of $83,309 resulting in a charge to equity upon recapitalization of $251,691. The Company is deemed to have issued 2,030,870 common shares to the original shareholders of IFLI. Following the purchase, the shares were cancelled. Upon closing of the reverse merger, IFLI Acquisition Corp. was renamed Simplepons, Inc. and Simplepons, Inc. was renamed Simplepons Operations, Inc. Simplepons, Inc. and Simplepons Operations, Inc. are hereafter referred to as the "Company". At closing, Company's stockholders owned approximately 97% of IFLI outstanding common stock, giving effect to the stock repurchase.

The accompanying consolidated financial statements include the accounts of Simplepons, Inc. and its wholly owned subsidiary Simplepons Operations, Inc. for the year ended December 31, 2012 and the period from February 7, 2011 (inception) to December 31, 2011. All intercompany accounts have been eliminated in the consolidation.

During the year, the Company was is in the business of the sale of coupon books and was developing a mobile coupon subscription that solves the problem of leaving your coupons at home. On February 5, 2013 the Company completed a business combination and subsequently the Board of Directors discontinued the existing coupon subscription business, see Note 15.

2. Summary of Significant Accounting Principles

(A) Going Concern

As reflected in the accompanying consolidated financial statement for the year ended December 31, 2012, the Company has a net loss of $2,520,574 and used cash in operations of $1,067,996. These factors raise substantial doubt about the Company’s ability to continue as a going concern. In addition there is a working capital deficiency of $577,902 and a stockholders’ deficit of $562,782 as of December 31, 2012.

The Company’s continued existence is dependent upon its ability to raise capital and to successfully market and sell its products. The financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

As of December 31, 2012, the Company had proceeds of 893,874, net of offering cost, from sales of common stock, and raised $103,000 in gross proceeds for working capital through the sale of convertible promissory notes to an accredited investor and an officer. Subsequent to year end the Company completed a merger and raised additional financing. The Company is in discussions with additional prospective investors and, while it has no firm commitments for additional capital, it reasonably expects to conclude additional capital rounds in 2013 which provide additional working capital to it. Management believes that actions presently being taken to obtain additional funding and implement its new strategic business plan, provide for the opportunity for the Company to continue as a going concern.

(B) Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reported period. Actual results could differ from those estimates.

The Company’s significant estimates and assumptions include the fair value of financial instruments; allowance for doubtful accounts; the carrying value, recoverability and impairment, if any, of long-lived assets, including the values assigned to and the estimated useful lives of property and equipment and website; interest rate; underlying assumptions to estimate the fair value of beneficial conversion features, warrants and options; revenue recognized or recognizable; sales returns and allowances; income tax rate, income tax provision, deferred tax assets and valuation allowance of deferred tax assets; and the assumption that the Company will continue as a going concern. Those significant accounting estimates or assumptions bear the risk of change due to the fact that there are uncertainties attached to those estimates or assumptions, and certain estimates or assumptions are difficult to measure or value.

Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable in relation to the financial statements taken as a whole under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

Management regularly evaluates the key factors and assumptions used to develop the estimates utilizing currently available information, changes in facts and circumstances, historical experience and reasonable assumptions. After such evaluations, those estimates are adjusted accordingly, if deemed appropriate.

(C) Cash and Cash Equivalents

The Company’s cash equivalents are short-term, highly liquid investments that are both readily convertible to known amounts of cash and that have insignificant risk of change in value because of changes in interest rates.

(D) Inventories

The Company’s inventories consist entirely of purchased finished goods. Inventories are stated at lower of cost or market. Cost is determined on the first-in, first-out basis. During the year ended December 31, 2012, the Company recorded an impairment of inventory in the amount of $36,569 which is also included in the cost of goods sold. Subsequent to year end no further sales of the coupon books were made and accordingly the impairment represent the unsalable goods of the discontinued operations.

(E) ***Property and Equipment***

The Company values property and equipment at cost and depreciates these assets using the straight-line method over their expected useful life. The Company uses a five year life for computer equipment and a three year life for software.

(F) Impairment

In accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification No. 360, *Property, Plant and Equipment*, the Company carries long-lived assets at the lower of the carrying amount or fair value. Impairment is evaluated by estimating future undiscounted cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected undiscounted future cash flow is less than the carrying amount of the assets, an impairment loss is recognized. Fair value, for purposes of calculating impairment, is measured based on estimated future cash flows, discounted at a market rate of interest.

(G) Website Development

The Company has adopted the provisions of FASB Accounting Standards Codification No. 350 *Intangible-Goodwill and Other*. Costs incurred in the planning stage of a website are expensed, while costs incurred in the development stage are capitalized and amortized over the estimated three year life of the asset. Subsequent to year end, the Company decided to discontinue the coupon subscriptions business, and determined that the website developed for coupon subscriptions operation would not have any future economic benefit. The carrying amount of the website in amount of $113,068 was recognized as impairment loss during the year ended December 31, 2012.

(H) Stock-Based Compensation

The Company recognizes compensation costs to employees under FASB Accounting Standards Codification No. 718, *Compensation - Stock Compensation*. Under FASB No. 718, companies are required to measure the compensation costs of share-based compensation arrangements based on the grant-date fair value and recognize the costs in the financial statements over the period during which employees are required to provide services. Share based compensation arrangements include stock options and warrants. As such, compensation cost is measured on the date of grant at their fair value. Such compensation amounts, if any, are amortized over the respective vesting periods of the option grant.

Equity instruments issued to other than employees are recorded on the basis of the fair value of the instruments, as required by FASB Accounting Standards Codification No. 505, *Equity Based Payments to Non-Employees.* In general, the measurement date is when either a (a) performance commitment, as defined, is reached or (b) the earlier of (i) the non-employee performance is complete or (ii) the instruments are vested. The measured value related to the instruments is recognized over a period based on the facts and circumstances of each particular grant as defined in the FASB Accounting Standards Codification.

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(I) Loss Per Share

Basic and diluted net loss per common share is computed based upon the weighted average common shares outstanding as defined by FASB Accounting Standards Codification No. 260, *Earnings Per Share*. As of December 31, 2012 there were 2,750,000 options, 24,658,790 warrants and 400,000 common shares issuable upon conversion of convertible notes payable outstanding whose effect was anti-dilutive and not included in diluted net loss per share for the year ended December 31, 2012. The options and warrants may dilute future earnings per share.

(J) Fair Value of Financial Instruments

Fair Value of Financial Instruments

The Company measures its financial and non-financial assets and liabilities, as well as makes related disclosures, in accordance with FASB Accounting Standards Codification No. 820, *Fair Value Measurement*, which provides guidance with respect to valuation techniques to be utilized in the determination of fair value of assets and liabilities. Approaches include, (i) the market approach (comparable market prices), (ii) the income approach (present value of future income or cash flow), and (iii) the cost approach (cost to replace the service capacity of an asset or replacement cost). ASC Topic 820 utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, such as valuations derived from valuation techniques in which one more significant inputs or significant value drivers are unobservable.

Our financial instruments include cash, accounts receivable, accounts payable, accrued liabilities, accrued salaries payable, liquidated damages payable, contingent liabilities, convertible note payable, convertible note payable – related party, and derivative liabilities.

The carrying values of the Company’s cash, accounts receivable, accounts payable, accrued liabilities, accrued salaries payable, liquidated damages payable, contingent liabilities approximate their fair value due to their short-term nature.

The Company’s convertible note payable and convertible note payable – related party are measured at amortized cost based upon management’s best estimate of interest rates that would be available to the company for similar financial

The derivative liabilities are stated at their fair value as a level 3 measurement. The Company used a Black-Scholes model to determine the fair values of these derivative liabilities. See Note 6 for the Company’s assumptions used in determining the fair value of these financial instruments.

(K) Business Segments

The Company operates in one segment and therefore segment information is not presented.

(L) Revenue Recognition

The Company recognizes revenue in accordance with FASB Accounting Standards Codification No. 605, *Revenue Recognition*. In all cases, revenue is recognized only when the price is fixed or determinable, persuasive evidence of an arrangement exists, delivery has occurred and collectability is reasonably assured. The criteria are met when the deal books are delivered to our customers and collectability is reasonably assured. The Company records these sales net of any discounts provided to the customer.

(M) Concentrations

During the year ended December 31, 2012 the Company had one customer who represented 15% of sales. The sales during year of 2011 were nominal.

(N) Income Taxes

The Company uses the asset and liability method in accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on difference between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates that will be in effect when the differences are expected to reverse. A valuation allowance is provided to offset any net deferred tax assets for which management believes it is more likely than not that the net deferred asset will not be realized.

(O) Convertible note payable

The Company accounts for convertible note payable in accordance with the FASB Accounting Standards Codification No. 815, *Derivatives and Hedging,* since the conversion feature is not indexed to the Company's stock and can't be classified in equity. The Company allocates the proceeds received from convertible note payable between the liability component and conversion feature component. The conversion feature that is considered embedded derivative liabilities has been recorded at their fair value as its fair value can be separated from the convertible note and its conversion is independent of the underlying note value. The Company has also recorded the resulting discount on debt related to the conversion feature and is amortizing the discount using the effective interest rate method over the life of the debt instruments.

(P) Derivative liabilities

The Company accounts for derivative liabilities in accordance with the FASB Accounting Standards Codification No. 815, *Derivatives and Hedging*. FASB Accounting Standards Codification 815 requires companies to recognize all derivative liabilities in the balance sheet at fair value, and marks it to market at each reporting date with the resulting gains or losses shown in the Consolidated Statement of Operations.

(Q) Recent Accounting Pronouncements

The Company has reviewed all recently issued, but not yet effective, accounting pronouncements up to ASU 2012-07, and does not believe the future adoption of any such pronouncements may be expected to cause a material impact on its consolidated financial condition or the consolidated results of its operations.

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3. Property and Equipment

At December 31, 2012 and 2011 property and equipment consisted of the following.

	2012	2011
Computers and equipment	$20,086	$13,468
Accumulated depreciation	(4,966)	(778)
Balance	$15,120	$12,690

Depreciation expenses for the year ended December 31, 2012 and for the period from February 7, 2011 to December 31, 2011 were $4,188 and $778, respectively.

4. Website Development

The website states at cost less accumulated amortization, consists of the following:

	2012	2011
Website	$156,907	$114,612
Accumulated depreciation	(43,839)	(8,301)
Impairment	(113,068)	
Balance	$-	$106,311

Depreciation expenses for the year ended December 31, 2012 and for the period from February 7, 2011 to December 31, 2011 were $35,538 and $8,301, respectively.

Subsequent to year end, the Company decided to discontinue the coupon subscriptions business, and determined that the website developed for coupon subscriptions operation would not have any future economic benefit. The carrying amount of the website in amount of $113,068 was recognized as impairment loss during the year ended December 31, 2012.

5. Convertible Note Payable

On October 26, 2012, the Company entered into a Securities Purchase Agreement with Asher Enterprises, Inc. ("Asher") pursuant to which we sold Asher a $63,000 principal amount convertible promissory note ("Asher Note") in a private transaction. The Company received gross proceeds of $63,000. The Company did not pay any commissions or finder's fees in this transaction, but paid legal fees of Asher's counsel in the amount of $3,000. The Note bears an interest rate of 8% per annum and is due on July 24, 2013, pursuant to which Asher has an option to convert all or any portion of the accrued interest and unpaid principal balance of the Asher Note into the Common Stock of the Company or its successors, at 58% of the market price, no sooner than April 24, 2013.

The Company has determined that the conversion feature of Asher Note represents an embedded derivative since Asher Note is convertible into a variable number of shares upon conversion. Accordingly, Asher Note is not considered to be conventional debt and the embedded conversion feature must be bifurcated from the debt host and accounted for as a derivative liability. Accordingly, the fair value of this derivative instrument has been recorded as a liability on the balance sheet with the corresponding amount recorded as a discount to Asher Note. Such discount will be accreted from the issuance date to the maturity date of Asher Note. The change in the fair value of the derivative liability will be recorded in other income or expenses in the consolidated statement of operations at the end of each period, with the offset to the derivative liability on the balance sheet. The beneficial conversion feature included in Asher Note resulted in an initial debt discount of $35,099. The fair value of the embedded derivative liability was determined using the Black-Scholes valuation model on the issuance date with the assumptions in the table below.

At December 31, 2012, the Company revalued the embedded derivative liability with the assumptions in the table below. For the period from the issuance date to December 31, 2012, the Company increased the derivative liability of $35,099 by $28,011 resulting in a derivative liability of $63,110 at December 31, 2012.

Reporting Date	Fair Value	Term (Years)	Assumed Conversion Price	Market Price on Issuance Date	Volatility Percentage	Risk-free Rate
10/26/12	$35,099	0.74	$0.234	$0.28	155%	0.018
12/31/12	$63,110	0.56	$0.019	$0.03	402%	0.018

The carrying value of Asher Note was $36,449, net of the remaining debt discount, as of December 31, 2012. The Company recorded interest expense related to this note of $1,227 and amortization of the debt discount in the amount of $8,548 during the year ended December 31, 2012. The interest expense of $1,227 has been included in accrued liabilities.

Asher Note	2012	2011
Proceeds	$63,000	-
Less derivative liabilities on initial recognition	(35,099)	-
Value of Asher Note on initial recognition	27,901	-
Add accumulated accretion expense	8,549	-
Balance as at December 31	$36,449	-

6. Derivative Liabilities

As of December 31, 2012, the Company's derivative liabilities are embedded derivatives associated with the Company's convertible note payable (Note 5). Due to the Asher Note's conversion feature, the actual number of shares of common stock that would be required if a conversion of the note as described in Note 4 was made through the issuance of the Company's common stock cannot be predicted. As a result, the conversion feature requires derivative accounting treatment and will be bifurcated from the note and "marked to market" each reporting period through the consolidated statement of operations.

The Company measured the fair value of the derivative liabilities as $35,099 on issuance date (October 26, 2012), and remeasured the fair value as $63,110 on December 31, 2012, and recorded the change of fair value of $28,011 in the consolidated statement of operations for the year ended December 31, 2012.

7. Convertible Note Payable - Related Party

On January 24, 2012, the Company entered into a 4% convertible promissory note with its former Chief Operating Officer in the amount of $40,000. The note is due on January 24, 2013. Prior to the maturity date, the Company has the option to convert the principle and accrued interest into shares of the Company's common stock at $0.10 per share. The fair value of the conversion was equal to the Company's stock price on the date of issuance and no beneficial conversion was recorded. Interest expense for the year ended December 31, 2012 amount to $1,499.

The Company is in default of the repayment of the promissory note with its former Chief Operating Office who has also filed a claim against the Company, see Note 10.

8. Liquidated Damages Payable

Pursuant to the Company's private placement completed in 2012 in the gross amount of $370,000, as of December 31, 2012 purchasers under the private placement (the "Holders") are entitled to liquidated damages if a registration statement covering the resale of the 1,480,000 shares of common stock sold under the private placement (the "Registrable Securities") is not filed within 60 days of the termination date of the private placement on May 15, 2012 and declared effective within 150 days of the termination date. The Company shall make pro rata payments to each Holder, in an amount equal to 1.0% of the aggregate amount invested by such Holder (based upon the number of Registrable Securities then owned by such Holder) for each 30-day period or pro rata for any portion thereof following the date by which such Registration Statement should have been filed or effective (the "Blackout Period"). Such payments can be made in cash or shares of common stock with the fair market value on the date of issuance and shall constitute the Holder's exclusive monetary remedy for such events, but shall not affect the right of the Holder to seek injunctive relief. The amounts payable as liquidated damages shall be paid monthly within ten (10) business days of the last day of each month following the commencement of the Blackout Period until the termination of the Blackout Period. Such payments shall be made to each holder at the sole option of the Company in either cash or shares of Common Stock. As of December 31, 2012, the Company has accrued seven months of liquidated damages payable in the amount of $25,900.

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9. Related Party Transactions

On January 24, 2012, the Company entered into a 4% convertible promissory note with its former Chief Operating Officer in the amount of $40,000 (Note 6).

10. Contingent Liabilities

As of December 31, 2012, the Company had contingent liabilities in amount of $23,062 in connection with the lawsuit filed by the Company’s former Chief Operating Officer. On October 17, 2012, the former Chief Operating Officer filed the complaint against the Company for non-payment of wages, vacation time and waiting time penalties under the California Labor Code Section 203. He is seeking $71,918 in base salary, $5,308 in wages for accrued vacation time and $17,309 in waiting time penalties, for an aggregate of $94,535, together with reasonable attorney’s fees. The balance of contingent liabilities recorded in the accompanying consolidated balance sheet represented the difference between aggregate amount in the lawsuit and accrued salaries to the former Chief Operating Officer.

11. Stockholders’ Equity

(A) Authorized Shares

The Company is authorized to issue 400,000,000 shares of common stock, par value $0.01 per shares and 1,000,000 shares of preferred stock, par value $0.0001 per share with rights and preferences to be determined by the Board of Directors.

(B) Sales of Common Stock

On January 20, 2012, the Company issued 450,000 Units of its securities in a private placement to two accredited investors. The price of these Units was $0.50 per unit. Each Unit consists of one share of common stock and one three year Series C Warrant. Each Series C Warrant entitles the holder to purchase one share of common stock at an exercise price of $0.50 per share. Upon 30 days’ notice, the Company has the right to call the warrants at $0.0001 per warrant if the Company’s stock is quoted for trading in the over the counter market, the closing price of our common stock is $.50 or more for five consecutive trading days and there is an effective registration statement covering the resale of the shares of common stock underlying the Series C Warrants. The Company received proceeds of $225,000. On September 20, 2012, the Company issued additional 1,800,000 shares to these two investors as adjustment to their purchase price to $0.1 per share, resolving price issues raised by the investors.

During the six months ended June 30, 2012 the Company issued 1,480,000 shares of common stock in a private placement to six accredited investors. The price of the common stock was $0.25 per share. Pursuant to the placement agent agreement the Company issued warrants to purchase 148,000 shares of common stock at a price of $.25 to the placement agent and paid a 10% commission and a 2% expense allowance and legal and professional fees of $138,626. The Company received net proceeds of $231,374.

During the three months ended September 30, 2012, the Company issued 2,550,000 Units of its securities in a private placement to accredited investors. The price of these Units was $0.10 per unit. Each Unit consists of one share of common stock and one three year Series D Warrant. Each Series D Warrant entitles the holder to purchase one share of common stock at an exercise price of $0.25 per share and the Company received proceeds of $255,000.

During the three months ended September 30, 2012, the Company issued 1,300,000 Units of its securities in a private placement to the accredited investors. The price of these Units was $0.10 per unit. Each Unit consists of one share of common stock and one three year Series E Warrant. Each Series E Warrant entitles the holder to purchase one share of common stock at an exercise price of $0.25 per share and subject to adjustments due to recapitalization or reclassification of common stock. The Company received proceeds of $130,000.

(C) Common Stock Issued for Services

In May 2011, the Company issued 4,000,000 shares of common stock valued at $200,000 ($0.05 per share) based on contemporaneous stock sales and $50,000 cash to a consultant for management consulting, business advisory, strategic planning and public relations. On August 26, 2011 the Company amended to agreement and agreed to pay the consultant an additional $50,000 for services under this agreement. On February 3, 2012, the Company agreed to amend a May 18, 2011 consulting agreement to pay the consultant an additional $30,000 upon receipt of additional funding. The term of the agreement is for one year and expires on May 17, 2012. Accordingly, expenses for the year ended December 31, 2012 and for the period from February 7, 2011 (Inception) to December 31, 2011 were $150,794 and $179,206, respectively.

In August 2011, the Company issued 4,000,000 shares of common stock valued at $200,000 ($0.05 per share) based on contemporaneous stock sales to a consultant for a variety of services to the Company, including industry analysis, identifying and introducing potential strategic partners to the Company, evaluations of competitors and development of strategies to increase the Company’s competitiveness and advice on effective management of relationships with investment banking firms. The original term of the agreement is for two years and expires on August 15, 2013. Since there are no services to be rendered in 2013 as a result of the change in operations of the Company in February 2013 (see Note 15), the balance of unrecognized expenses was expended in 2012. Accordingly, expenses for the year ended

December 31, 2012 and for the period from February 7, 2011 (Inception) to December 31, 2011 were $162,500 and $37,500, respectively.

In August 2011, the Company issued 2,000,000 shares of common stock valued at $100,000 ($0.05 per share) based on contemporaneous stock sales to a consultant for a variety of services to the Company, including industry analysis, identifying and introducing potential strategic partners to the Company, evaluations of competitors and development of strategies to increase the Company's competitiveness and advice on effective management of relationships with investment banking firms. The original term of the agreement is for two years and expires on August 15, 2013. Since there are no services to be rendered in 2013 as a result of the change in operations of the Company in February 2013 (see Note 15), the balance of unrecognized expenses was expended in 2012. Accordingly, expenses for the year ended December 31, 2012 and for the period from February 7, 2011 (Inception) to December 31, 2011 were $81,250 and $18,750, respectively.

On February 15, 2012, the Company engaged an investment banking firm to serve as our exclusive financial advisor. Under the terms of the one year agreement, the investment banker will provide the Company with financial advisory and investment banking services for an annual fee of $60,000. The Company has agreed to reimburse the investment banking firm for its expenses incurred in connection with the engagement and to pay it certain additional transactional fees. The Company has also granted the investment bank firm the right to serve as our investment banker for any private or public offering of our securities and in certain other transactions, upon such terms as the parties may mutually agree. As of December 31, 2012 accrued investment banking fees amounted to $52,500.

In June 2012, the Company issued 300,000 shares of common stock valued at $75,000 ($0.25 per share) based on contemporaneous stock sales to a consultant for investor relations. All shares were considered earned upon receipt. Expense for the year ended December 31, 2012 amounted to $75,000.

On July 23, 2012, the Company issued 900,000 shares of common stock valued at $90,000 ($0.10 per share) based on contemporaneous stock sales to a consultant for a variety of services to the Company, including existing practices evaluation, strategies development in connection with corporate and brand identity, advertising and new business support. All shares were considered earned upon receipt. Expense for the year ended December 31, 2012 amounted to $90,000.

On August 1, 2012, the Company issued 450,000 shares of common stock valued at $45,000 ($0.10 per share) based on contemporaneous stock sales to a consultant for a variety of services to the Company, including existing practices evaluation, strategies development in connection with corporate and brand identity, advertising and new business support. All shares were considered earned upon receipt. Expense for the year ended December 31, 2012 amounted to $45,000.

On August 6, 2012, the Company issued 600,000 shares of common stock valued at $60,000 ($0.10 per share) based on contemporaneous stock sales to a consultant for a variety of services to the Company, including investor and public relations assessment, marketing surveys, investor support, and strategic business planning. All shares were considered earned upon receipt. Expense for the year ended December 31, 2012 amounted to $60,000.

On October 31, 2012, the Company issued 1,000,000 shares of common stock with a fair value of $100,000 to a consultant for a variety of services to the Company, including accounting services related to the preparation and filing of the Company's quarterly and annual reports, EDGAR services, and the preparation of corporate tax returns. All shares were considered earned upon receipt. Expense for the year ended December 31, 2012 amounted to $100,000.

(D) Stock Options

On November 1, 2011, the Company granted a total of 4,100,000 stock options to employees and officers including 2,500,000 options to Officers. The option vest quarterly over a period of three years and have an exercise price of $0.275 per share. The Options were valued using the Black-Scholes Option Pricing Model with the following assumptions: dividend yield of 0%, annual volatility of 87%, risk free interest rate of .87%, and expected life of 4 years. For the year ended December 31, 2012 the Company expensed $72,184 as the fair value.

During the first quarter of 2012, the Company granted a total of 4,300,000 stock options to employees and officers including 4,000,000 options to officers. The option vest quarterly over a period of three years and have an exercise price of $0.75 per share. The options were valued at $539,177 using the Black-Scholes Option Pricing Model with the following assumptions: dividend yield of 0%, annual comparative companies volatility due to the stock being thinly traded of 101%, risk free interest rate of .87%, and expected life of 4 years using the simplified method. For the year ended December 31, 2012 the Company expensed $86,728.

On April 30, 2012, the Company hired a Director of Engineering. Under the terms of the employment offer letter agreement, the Director of Engineering receives an annual salary of $115,000 and will be eligible to participate in our existing benefit programs. As additional compensation, the Company granted options to purchase 800,000 shares of common stock with an exercise price of $0.45 per share that vest quarterly in arrears over three years. Employment is terminable by either party at any time, with or without cause. The options were valued at $118,640 using the Black-Scholes Option Pricing Model with the following assumptions: dividend yield of 0%, annual comparative companies volatility due to the stock being thinly traded of 101%, risk free interest rate of .39%, and expected life of four years using the simplified method. For the year ended December 31, 2012 the Company expensed $9,887.

Options:	**Shares**	**Weighted Avg. Exercise Price**
Balance, December 31, 2011	4,100,000	$ 0.275

Granted	5,700,000	0.71
Exercised	—	—
Forfeited	(7,050,000)	0.63
Balance at December 31, 2012	2,750,000	$ 0.275
Options exercisable at December 31, 2012	1,960,656	$ 0.275

The following table summarizes information about options for the Company as of December 31, 2012:

	2012 Options Outstanding			**Options Exercisable**	
Range of Exercise Price	**Number Outstanding at December 31, 2012**	**Weighted Average Remaining Contractual**	**Weighted Average Exercise Price**	**Number Exercisable at December 31, 2012**	**Weighted Average Exercise Price**
$ 0.275	2,750,000	3.838	$ 0.275	1,960,656	$ 0.275

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12. Warrants

The following tables summarize all warrant grants for the year ended December 31, 2012, and the related changes during this period.

	Number of Warrants	Weighted Average Exercise Price
Stock Warrants		
Balance at December 31, 2011	20,879,412	$ 0.92
Granted	4,448,000	0.28
Exercised	—	—
Expired	(668,622)	0.38
Balance at December 31, 2012	24,658,790	0.26
Warrants Exercisable at December 31, 2012	24,658,790	$ 0.26

In connection with a private placement in 2007, the Company issued 13,976,180 warrants with an exercise price of $1.05 that expires between March 1, 2012 to March 15, 2017. The exercise price and number of warrant shares issuable upon exercise of the warrants are subject to adjustment from time to time for stock dividends and splits and fundamental transactions, which include a merger or consolidation or any sale of all or substantially all of the Company's assets, any tender offer or exchange offer is completed pursuant to which holders of the Company's common stock are permitted to tender or exchange their shares for other securities, cash or property, or any reclassification of the Company's common stock or any compulsory share exchange pursuant to which the Company's common stock is effectively converted into or exchanged for other securities, cash or property. The warrants also contain a cashless exercise provision. In the case of a fundamental transaction, the warrant holders will be entitled to rights equivalent to the common shareholders as if the warrant shares were issued immediately prior to the fundamental transaction. The investor warrants also provide that if the Company offers or sells stock in a subsequent equity sale at a price below the warrant exercise price then in effect, then the number of warrant shares issuable will be increased such that the aggregate exercise price of the warrants, after taking into account an equivalent price decrease, shall be equal to the aggregate exercise price prior to such adjustment ("reset provision"). Under ASC 815-40-15, the Company is required to account for warrants with reset provisions when the following three items are present (1) one or more underlying amounts or payments are required (2) no initial net investment or an initial net investment that is smaller than would be required for other types of contracts (3) its terms require or permit net settlement, it can be readily settled net by means outside the contract or it provides for delivery of an asset that puts the recipient in a position not substantially different from the net settlement. ASC 815-40-15 further defines the requirement that the assets are readily convertible to cash. Due to the lack of a public market for the Company's securities, the Company determined that the warrants were not readily convertible to cash and therefore no derivative liability has been recorded. As of December 31, 2012, the total warrants outstanding in connection with this 2007 private placement are 790 warrants with a weighted average exercise price of $0.39 per share.

13. Income tax

The Company's income tax expense differs from the "expected" tax expense for federal income tax purpose by applying the Federal & State blended rate of 37.63% as follows:

	For the year ended December 31, 2012	For the period ended December 31, 2011
Expected income tax benefit (expense) at the statutory rate of 37.63%	$(948,492)	(313,003)
Tax effect of expenses that are not deductible for income tax purposes	333,237	102,906
Change in valuation allowance	615,255	210,097
Provision for income taxes	$—	—

The components of deferred taxes assets are as follows:

	2012	2011
Deferred tax asset:		
Net operating loss carryforwards	$2,193,334	558,321
Effective tax rate	37.63 %	37.63 %
Deferred taxes assets	825,352	210,097
Valuation allowance	(825,352)	(210,097)
Deferred taxes assets, net	$—	—

As of December 31, 2012, the Company has a net operating loss carry forward of approximately $2,193,334 (2011 – 558,321) available to offset future taxable income through 2032. This results in deferred tax assets of approximately $825,352 (2011 – 210,097) as of December 31, 2012. The valuation allowance at December 31, 2012 was approximately $825,352 (2011 – 210,097). The change in the valuation allowance for the year ended December 31, 2012 was an increase of $615,255.

The Company's federal income tax return for the year ended December 31, 2012 is subject to examination by the Internal Revenue Service.

14. Commitments and contingencies

(A) Lease agreement

The Company is committed under operating lease agreement for the rental of its premises. The minimum annual future lease payment is from approximately $124,800 in year one to approximately $135,800 in year five. The lease will be terminated on December 31, 2016.

(B) Contingencies

The Company is a defendant in an action commenced by the Company's former Chief Operating Officer, who filed a complaint against the Company in October 2012 for non-payment of wages, vacation time and waiting time penalties under the California Labor Code Section 203. The plaintiff is seeking $71,918 in base salary, $5,308 in wages for accrued vacation time and $17,309 in waiting time penalties, for an aggregate of $94,535, together with reasonable attorney's fees. The Company is seeking a dismissal of the lawsuit citing that the former COO's employment agreement, which is the basis of the claims, provides that it the 15th Judicial Circuit of Florida is the venue and exclusive forum in which to adjudicate any case or controversy that arises in connection with the employment agreement. The Company intends to vigorously defend this action.

15. Financial Instruments

(A) Fair Values

The Company's financial instruments consist of cash, accounts receivable, accounts payable, accrued liabilities, accrued salaries payable, liquidated damages payable, contingent liabilities, convertible note payable, convertible note payable – related party, and derivative liabilities. The fair values of these financial instruments approximate their carrying values due to the short-term maturity of these instruments.

The carrying values of the Company's cash, accounts receivable, accounts payable, accrued liabilities, accrued salaries payable, liquidated damages payable, contingent liabilities approximate their fair value due to their short-term nature.

The Company's convertible note payable and convertible note payable – related party are measured at amortized cost based upon management's best estimate of interest rates that would be available to the company for similar financial

The derivative liabilities are stated at their fair value as a level 3 measurement. The Company used a Black-Scholes model to determine the fair values of these derivative liabilities. See Note 5 for the Company's assumptions used in determining the fair value of these financial instruments.

(B) Liquidity Risk

Liquidity risk is the risk that the Company's cash flows from operations will not be sufficient for the Company to continue operating and discharge is liabilities. The Company is exposed to liquidity risk as its continued operation is dependent upon its ability to obtain financing, either in the form of debt or equity, or achieving profitable operations in order to satisfy its liabilities as they come due.

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16. Subsequent Events

(A) Share Exchange Transaction

On February 5, 2013 the Company finalized a share exchange agreement whereby the Company issued 1,702,235,971 exchangeable shares for 100% of the common stock of Eco-Shift Power Corp., a Canadian corporation. The exchangeable shares are exchangeable at the option of the holder, each into one share of common stock of the Company. In addition the Company issued one Series B Preferred share, the terms of which are detailed below.

As a result of the Share Exchange, Eco-Shift Power Corp. is now a wholly-owned subsidiary of the Company. This transaction will be accounted for as reverse merger.

(B) Note Modification

Concurrently with the closing of the Share Exchange, the Company entered into a modification agreement (the "Amendment") to that Certain Convertible Promissory Note (the "Note") originally issued on October 26, 2012, by the Company in favor of Asher Enterprises, Inc. ("Asher") in the principal amount of $63,000. The Note was subsequently assigned to Linear Group Holdings, Inc. ("Linear") pursuant to that certain Assignment Agreement dated February 8, 2013 (the "Assignment Agreement"), by and among Asher, Linear and the Company. Pursuant to the Amendment, the Note shall be convertible at the option of Linear into an aggregate amount of 632,260,655 shares of the Company's common stock.

(C) Increase in Authorized Capital

The Certificate of Incorporation of the Company authorizes the issuance of up to 5,000,000 shares of preferred stock and further authorizes the Board of Directors to fix and determine the designation, preferences, conversion rights, or other rights, including voting rights, qualifications, limitations, or restrictions of the preferred stock. On January 31, 2013, the Board approved by unanimous written consent an amendment to the Company's Certificate of Incorporation to designate the rights and preferences of the Series B Preferred.

(D) Certificate of Designation

On February 1, 2013, the Company filed the Certificate of Designation with the State of Delaware Secretary of State pursuant to which the Company set forth the designation, powers, rights, privileges, preferences and restrictions of the Series B Preferred.

Among other things, the share of the Series B Preferred has voting rights equal to the number of Exchangeable Shares that are issued and outstanding as of the record date, except for any Exchangeable Shares owned by any subsidiary of the Company. The Company has authorized one (1) share of Series B Preferred.

(E) Discontinued Operations

Subsequent to the Share Exchange and the commencement of the Eco-Shift Power Corp. business operations, the Company decided to discontinue the mobile coupon subscription operations.

(F) Sales of Common Stock

In March 2013, the Company issued 6,200,000 shares of common stock in a private placement to seven accredited investors. The price of the common stock was $0.05 per share, and the Company received proceeds of $310,000.