

INSIGNIA SOLUTIONS PLC

Form 10-Q

August 19, 2005

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**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

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

**For the quarterly period ended June 30, 2005**

**or,**

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

**For the transition period from \_\_\_ to \_\_\_**

**Commission file number 0-27012**

**Insignia Solutions plc**

**(Exact name of Registrant as specified in its charter)**

**England and Wales**

(State or other jurisdiction of  
incorporation or organization)

**Not applicable**

(I.R.S. employer identification  
number)

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

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act):

Yes  No

As of June 30, 2005, there were 42,433,025 ordinary shares of £0.20 each nominal value, outstanding.

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**INSIGNIA SOLUTIONS PLC**

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**INSIGNIA SOLUTIONS PLC**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(unaudited, amounts in thousands, except share amounts)

|  | <b>June 30,</b> | <b>December</b> |
|--|-----------------|-----------------|
|  | <b>2005</b>     | <b>31,</b>      |
|  |                 | <b>2004</b>     |
| <b>ASSETS</b>  |                 |                 |
| Current assets:  |                 |                 |
| Cash and cash equivalents  | \$ 842          | \$ 902          |
| Restricted cash  | 50              | 50              |
| Accounts receivable, net of allowances of \$195 and \$0, respectively  | 617             | 175             |
| Other receivables  | 66              | 241             |
| Tax receivable   | 137             | 322             |
| Prepaid expenses   | 261             | 456             |
| <br>   |                 |                 |
| Total current assets   | 1,973           | 2,146           |
| <br>   |                 |                 |
| Property and equipment, net  | 123             | 140             |
| Intangible assets, net   | 2,290           |                 |
| Goodwill   | 416             |                 |
| Investment in affiliate  |                 | 68              |
| Other assets   | 228             | 233             |
|  | \$ 5,030        | \$ 2,587        |
| <br><b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                 |                 |
| Current liabilities:   |                 |                 |
| Accounts payable   | \$ 779          | \$ 241          |
| Accrued liabilities  | 1,234           | 995             |
| Notes payable  | 64              |                 |
| Deferred revenue   | 118             | 10              |
| <br>   |                 |                 |
| Total current liabilities  | 2,195           | 1,246           |
| <br>   |                 |                 |
| Commitments and contingencies (Note 6)   |                 |                 |
| <br>   |                 |                 |
| Shareholders equity:   |                 |                 |
| Preferred shares, £0.20 par value: 3,000,000 shares authorized; no shares issued   |                 |                 |
| Ordinary shares, £0.20 par value: 75,000,000 shares authorized; 42,433,025 and 35,722,205 shares issued and outstanding in 2005 and 2004, respectively | 14,470          | 11,939          |
| Additional paid-in capital   | 66,199          | 64,459          |
| Ordinary share subscription  | 712             |                 |
| Accumulated deficit  | (78,085)        | (74,596)        |
| Other accumulated comprehensive loss   | (461)           | (461)           |

|                            |          |          |
|----------------------------|----------|----------|
| Total shareholders' equity | 2,835    | 1,341    |
|                            | \$ 5,030 | \$ 2,587 |

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

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**INSIGNIA SOLUTIONS PLC**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(unaudited, amounts in thousands, except per share amounts)

|   | Three months ended |            | Six months ended |            |
|---|--------------------|------------|------------------|------------|
|   | June 30,           |            | June 30,         |            |
|   | 2005               | 2004       | 2005             | 2004       |
| Net revenues:   |                    |            |                  |            |
| License   | \$ 500             | \$ 105     | \$ 917           | \$ 421     |
| Service   | 234                | 2          | 279              | 5          |
| Total net revenues  | 734                | 107        | 1,196            | 426        |
| Expenses:   |                    |            |                  |            |
| Cost of net revenues  | 94                 | 5          | 99               | 28         |
| Sales and marketing   | 667                | 529        | 1,329            | 1,345      |
| Research and development  | 767                | 661        | 1,591            | 1,472      |
| General and administrative  | 703                | 670        | 1,484            | 1,261      |
| Amortization of intangible assets   | 97                 |            | 110              |            |
| Total operating expenses  | 2,328              | 1,865      | 4,613            | 4,106      |
| Operating loss  | (1,594)            | (1,758)    | (3,417)          | (3,680)    |
| Interest income (expense), net  | (43)               | 3          | (42)             | 2          |
| Other income (expense), net   | 37                 | 264        | 6                | 251        |
| Loss before income taxes  | (1,600)            | (1,491)    | (3,453)          | (3,427)    |
| Provision for (benefit from) income taxes                                   |                    | (187)      | 36               | (213)      |
| Net loss  | (1,600)            | (1,304)    | (3,489)          | (3,214)    |
| Deemed dividend related to beneficial conversion feature of preferred stock | (415)              |            | (415)            |            |
| Net loss attributable to ordinary shareholders                              | \$ (2,015)         | \$ (1,304) | \$ (3,904)       | \$ (3,214) |
| Basic and diluted net loss per share  | \$ (0.05)          | \$ (0.04)  | \$ (0.10)        | \$ (0.11)  |
| Weighted average shares and share equivalents:                              |                    |            |                  |            |
| Basic and diluted   | 42,407             | 29,240     | 40,956           | 28,928     |

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

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**INSIGNIA SOLUTIONS PLC**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(unaudited, amounts in thousands)**

|  | <b>Six months ended</b> |             |
|--|-------------------------|-------------|
|  | <b>June 30,</b>         |             |
|  | <b>2005</b>             | <b>2004</b> |
| Cash flows from operating activities:  |                         |             |
| Net loss   | \$(3,489)               | \$(3,214)   |
| Adjustments to reconcile net loss to net cash used in operating activities:    |                         |             |
| Depreciation   | 53                      | 53          |
| Amortization of intangible assets  | 110                     |             |
| Allowance for doubtful accounts  | 195                     |             |
| Non-cash charge for warrants, shares and stock options                         | 65                      | 353         |
| Equity in net loss of affiliate  | 68                      | 40          |
| Gain on sale of product line   |                         | (298)       |
| Net changes in assets and liabilities, net of acquired assets and liabilities: |                         |             |
| Accounts receivable  | (496)                   | (195)       |
| Other receivables  | 187                     | (428)       |
| Tax receivable   | 190                     | (45)        |
| Prepaid royalties  |                         | 2,185       |
| Prepaid expenses   | 206                     | 61          |
| Other noncurrent assets  | 5                       | (7)         |
| Accounts payable   | 457                     | (251)       |
| Accrued liabilities  | 187                     | (106)       |
| Deferred revenue   | (113)                   | (821)       |
| Net cash used in operating activities  | (2,375)                 | (2,673)     |
| Cash flows from investing activities:  |                         |             |
| Investment in affiliate  |                         | (75)        |
| Acquisition of Mi4e, net of cash acquired                                      | 201                     |             |
| Increase in restricted cash  |                         | (30)        |
| Purchases of property and equipment  | (12)                    | (58)        |
| Net cash provided by (used in) investing activities                            | 189                     | (163)       |
| Cash flows from financing activities:  |                         |             |
| Proceeds from issuance of shares, net  | 2,081                   | 1,604       |
| Proceeds from exercise of warrants   |                         | 389         |
| Proceeds from exercise of stock options and employee stock purchases           | 89                      | 581         |
| Repayment of notes payable   | (44)                    |             |
| Net cash provided by financing activities                                      | 2,126                   | 2,574       |
| Net decrease in cash and cash equivalents                                      | (60)                    | (262)       |

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|  |          |          |
|--|----------|----------|
| Cash and cash equivalents at beginning of the period | 902      | 2,212    |
| Cash and cash equivalents at end of the period       | \$ 842   | \$ 1,950 |
| Non-cash issuance of shares for acquired business    | \$ 2,749 | \$       |

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

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**INSIGNIA SOLUTIONS PLC  
NOTES TO CONDENSED CONSOLIDATED  
FINANCIAL STATEMENTS  
(unaudited)**

**Note 1. Basis of presentation**

The accompanying unaudited condensed consolidated financial statements of Insignia Solutions plc ( Insignia , us , our , we or the Company ) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the instructions to Form 10-Q. The unaudited interim financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation. Interim results are not necessarily indicative of results for a full year. These unaudited condensed consolidated financial statements and notes should be read in conjunction with Insignia s audited consolidated financial statements for the year ended December 31, 2004 and footnotes thereto, included in Insignia s Annual Report on Form 10-K.

During the past 24 months, we have incurred an aggregate loss from operations and negative operating cash flows of \$14.5 million and \$12.0 million, respectively. As part of our strategy for ongoing funding we have entered into a securities subscription agreement with Fusion Capital Fund II, LLC ( Fusion Capital ). Under this securities subscription agreement, Fusion Capital has agreed to purchase on each trading day after the commencement of funding, \$20,000 of our American Depository Shares ( ADSs ), for an aggregate of up to \$12 million over a 30-month period, subject to earlier termination at our discretion. The commencement of funding under the securities subscription agreement is subject to certain conditions, including the declaration of effectiveness by the Securities and Exchange Commission of a registration statement covering the sale of the ADSs issued to Fusion Capital under the securities subscription agreement. There can be no assurance as to whether, or when, these conditions will be satisfied. Any delay in the commencement of funding under the Fusion Capital securities subscription agreement could jeopardize Insignia s business.

By instituting cost cutting measures through consolidating our global research and development activities, increasing revenue streams, collecting current outstanding receivables and subject to the commencement of funding under the Fusion Capital securities subscription agreement we believe we should be able to meet our operating and capital requirements.

The failure to raise additional funds, if needed, on a timely basis and on sufficiently favorable terms could have a material adverse effect on our business, operating results and financial condition. Insignia s liquidity may also be adversely affected in the future by factors such as an inability to borrow without collateral, availability of capital financing and continued operating losses. The accompanying unaudited condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We follow accounting principles generally accepted in the United States of America. We conduct our business in U.S. dollars, Euros and British pounds, and since March 16, 2005, also in Swedish Krona. All amounts included in the financial statements and in the notes herein are in U.S. dollars unless designated £ , in which case they are in British pounds.

**Note 2. Net loss per share**

Net loss per share is presented on a basic and diluted basis, and is computed by dividing our net loss attributable to ordinary shares by the weighted average number of ordinary shares and ordinary equivalent shares outstanding during the period. Ordinary equivalent shares consist of warrants and stock options that have a dilutive effect (using the treasury stock method). Under the basic method of calculating net loss per share, ordinary equivalent shares are excluded from the computation. Under the diluted method of calculating net loss per share, ordinary equivalent shares were excluded from the computation because their effect was anti-dilutive, due to our net loss.

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The calculation of basic and diluted net loss per share is as follows:

|   | (in thousands, except per share data) |            |                              |            |
|---|---------------------------------------|------------|------------------------------|------------|
|   | Three months<br>ended<br>June 30,     |            | Six months ended<br>June 30, |            |
|   | 2005                                  | 2004       | 2005                         | 2004       |
| Numerator basic and diluted:  |                                       |            |                              |            |
| Net loss attributable to ordinary shareholders  | \$ (2,015)                            | \$ (1,304) | \$ (3,904)                   | \$ (3,214) |
| Denominator of basic net loss per share:  |                                       |            |                              |            |
| Weighted average number of ordinary shares outstanding  | 42,407                                | 29,240     | 40,956                       | 28,928     |
| Basic net loss per share  | \$ (0.05)                             | \$ (0.04)  | \$ (0.10)                    | \$ (0.11)  |
| Denominator of diluted net loss per share:  |                                       |            |                              |            |
| Weighted average number of ordinary shares outstanding<br>Dilutive ordinary equivalent shares | 42,407                                | 29,240     | 40,956                       | 28,928     |
| Weighted average number of ordinary shares outstanding  | 42,407                                | 29,240     | 40,956                       | 28,928     |
| Diluted net loss per share  | \$ (0.05)                             | \$ (0.04)  | \$ (0.10)                    | \$ (0.11)  |

Options to purchase 4,307,958 and 1,664,314 shares of ordinary shares and warrants to purchase 8,869,266 and 325,185 ordinary shares were outstanding at June 30, 2005 and 2004, respectively, but were not included in the computation of diluted net loss per share as the effect would be anti-dilutive.

**Note 3. Stock-based compensation**

Insignia accounts for stock-based employee compensation using the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations and complies with the disclosure provisions of Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure an Amendment of FASB Statement No.123. The following table illustrates the effect on our net loss and net loss per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards No.123 ( SFAS 123 ), Accounting for Stock-Based Compensation to stock-based compensation.

|   | Three months ended<br>June 30, |            | Six months ended<br>June 30, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2005                           | 2004       | 2005                         | 2004       |
| Net loss attributable to ordinary shareholders as reported                        | \$ (2,015)                     | \$ (1,304) | \$ (3,904)                   | \$ (3,214) |
| Less stock-based compensation expense determined under<br>fair value based method | (37)                           | (204)      | (70)                         | (390)      |
| Net loss pro forma  | \$ (2,052)                     | \$ (1,508) | \$ (3,974)                   | \$ (3,604) |
| Basic and diluted net loss per share as reported                                  | \$ (0.05)                      | \$ (0.04)  | \$ (0.10)                    | \$ (0.11)  |
| Basic and diluted net loss per share pro forma                                    | \$ (0.05)                      | \$ (0.05)  | \$ (0.10)                    | \$ (0.12)  |

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In accordance with the disclosure provisions of SFAS 123, the fair value of employee stock options granted during the three and six months ended June 30, 2005 and 2004 was estimated at the date of grant using the Black-Scholes model and the following assumptions:

|                               | Three months ended |              | Six months ended |              |
|-------------------------------|--------------------|--------------|------------------|--------------|
|                               | June 30,           |              | June 30,         |              |
|                               | 2005               | 2004         | 2005             | 2004         |
| Stock Options:                |                    |              |                  |              |
| Volatility range              | 272 - 276%         | 139 - 140%   | 104 - 276%       | 139 - 198%   |
| Risk-free interest rate range | 4.21 - 4.28%       | 3.75 - 4.07% | 3.88 - 4.33%     | 1.11 - 4.07% |
| Dividend yield                | 0%                 | 0%           | 0%               | 0%           |
| Expected life (years)         | 4                  | 4            | 4                | 4            |
| Employee Stock Purchase Plan: |                    |              |                  |              |
| Volatility range              | N/A                | N/A          | 84%              | 198%         |
| Risk-free interest rate range | N/A                | N/A          | 2.93%            | 1.13%        |
| Dividend yield                | 0%                 | 0%           | 0%               | 0%           |
| Expected life (years)         | 0.5                | 0.5          | 0.5              | 0.5          |

**Note 4. New accounting pronouncements**

In December 2004, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment ( SFAS 123R ), a revision to SFAS 123. SFAS 123R addresses all forms of share-based payment ( SBP ) awards, including shares issued under our 1995 Incentive Stock Option Plan ( Purchase Plan ), stock options, restricted stock, restricted stock units and stock appreciation rights. SFAS 123R will require Insignia to record compensation expense for SBP awards based on the fair value of the SBP awards. Under SFAS 123R, restricted stock and restricted stock units will generally be valued by reference to the market value of freely tradable shares of the Company's ordinary shares. Stock options, stock appreciation rights and shares issued under the Purchase Plan will generally be valued at fair value determined through an option valuation model, such as a lattice model or the Black-Scholes model (the model that Insignia currently uses for its footnote disclosure). SFAS 123R is effective for annual periods beginning after June 15, 2005 and, accordingly, Insignia must adopt the new accounting provisions effective January 1, 2006. The Company will adopt the provisions of SFAS 123R using a modified prospective application. Under a modified prospective application, SFAS 123R will apply to new awards and to awards that are outstanding on the effective date and are subsequently modified or cancelled. Compensation expense for outstanding awards for which the requisite service had not been rendered as of the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under SFAS 123. Insignia is in the process of determining how the new method of valuing stock-based compensation as prescribed in SFAS 123R will be applied to valuing share-based awards granted after the effective date and the impact the recognition of compensation expense related to such awards will have on its consolidated financial statements.

In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements ( SFAS 154 ). SFAS 154 will require companies to account for and apply changes in accounting principles retrospectively to prior periods' financial statements, instead of recording a cumulative effect adjustment within the period of the change, unless it is impracticable to determine the effects of the change to each period being presented. SFAS 154 is effective for accounting changes made in annual periods beginning after December 15, 2005 and, accordingly, we must adopt the new accounting provisions effective January 1, 2006. We do not expect the adoption of SFAS 154 to have a material effect on our financial position, results of operations or cash flows.

**Note 5. Mi4e Acquisition**

On March 16, 2005, we acquired 100% of Mi4e Device Management AB ( Mi4e ), a private company headquartered in Stockholm, Sweden. The consideration paid in the transaction was 2,969,692 American depositary shares ( ADSs ) representing ordinary shares, and another 989,896 ADSs are issuable on March 31, 2006, subject to potential offset for

breach of representations, warranties and covenants. In addition, up to a maximum of 700,000 Euros is payable in cash in a potential earn-out based on a percentage of future revenue collected from sales of existing Mi4e products. As of June 30, 2005, \$22,000 has been earned. Mi4e develops, markets and supports software technologies that enable mobile operators and phone manufacturers to update firmware of mobile devices using standards over-the-air data networks. Its main product, a Device Management Server ( DMS ) is a mobile device management infrastructure solution for mobile operators that support the Open Mobile Alliance ( OMA ) Client Provisioning Specification. The initial purchase price of approximately \$3.0 million consisted of 3,959,588 ordinary shares (including the shares issuable in March 2006) with a value of approximately \$2,749,000 and acquisition costs of approximately \$267,000. The fair value of Insignia s ordinary shares was determined using an average value of \$0.6943 per share, which was the average closing price of Insignia s ordinary shares three days before and after the measurement date of February

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10, 2005. The shares issuable in March 2006 have been recorded as an ordinary share subscription on the condensed consolidated balance sheet. Any earn-out amounts payable by Insignia to Mi4e's shareholders will be recorded as additional purchase price and an increase to goodwill, and such amounts are not included in the initial purchase price. Insignia allocated the initial purchase price to the tangible net assets and intangible assets acquired and liabilities assumed, based on their estimated fair values.

The initial purchase price is allocated as follows (in thousands):

**Allocation of Purchase Price:**

|                           |              |
|---------------------------|--------------|
| Tangible assets acquired  | \$ 497       |
| Liabilities assumed       | (275)        |
| Goodwill(a)               | 394          |
| Customer relationships(b) | 900          |
| Technology (c)            | 1,500        |
| <br>Total purchase price  | <br>\$ 3,016 |

- (a) Goodwill represents the excess of the purchase price over the fair value of the net assets acquired and liabilities assumed.
- (b) Customer relationships will be amortized over 10 years, the period of time Insignia estimates it will benefit from the acquired customer relationship.
- (c) Technology will be amortized over 5 years, the period of time Insignia estimates it will benefit from the technology acquired.

In performing the purchase price allocation of acquired intangible assets, Insignia considered its intention for future use of the assets, analysis of historical financial performance and estimates of future performance of Mi4e's products, among other factors. Insignia obtained an independent third party appraisal to determine the fair values of the above intangible technology assets using the residual income method, and for the customer relationships the income approach method was used.

The excess of the purchase price over the fair value of the identifiable tangible and intangible net assets acquired and liabilities assumed of \$394,000 was assigned to goodwill. In accordance with SFAS No. 142 Goodwill and Other Intangible Assets (SFAS 142), goodwill will not be amortized but will be tested for impairment at least annually. This amount is not deductible for tax purposes.

The following table presents unaudited summarized combined results of operation of Insignia and Mi4e, on a pro forma basis, as though the companies had been combined as of the beginning of each period presented after giving effect to certain purchase accounting adjustments. The operating results of Mi4e have been included in Insignia's condensed consolidated financial statements after March 16, 2005, the date of acquisition. The following unaudited pro forma amounts are in thousands, except the per share amounts.

|  | <b>Six months ended</b> |             |
|--|-------------------------|-------------|
|  | <b>June 30,</b>         |             |
|  | <b>2005</b>             | <b>2004</b> |
| Net revenues                                   | \$ 1,409                | \$ 674      |
| Net loss attributable to ordinary shareholders | \$(4,065)               | \$(3,521)   |
| Net loss per share Basic and diluted           | \$ (0.10)               | \$ (0.11)   |

The above unaudited pro forma summarized results of operations are intended for informational purposes only and, in the opinion of management, are neither indicative of the results of operations of Insignia had the acquisition actually taken place as of the beginning of the periods presented, nor indicative of Insignia's future results of operations. In addition, the above unaudited pro forma summarized results of operations do not include potential cost savings from operating efficiencies or synergies that may result from Insignia's acquisition of Mi4e.



**Table of Contents****Note 6. Commitments and Contingencies**

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

In our sales agreements, we typically agree to indemnify our customers for any expenses or liability resulting from claimed infringements of patents, trademarks or copyrights of third parties. The terms of these indemnification provisions are generally perpetual any time after the execution of the agreement. The maximum amount of potential future indemnification is unlimited. To date we have not paid any amounts to settle claims or defend lawsuits.

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

Insignia warrants its software products against defects in material and workmanship under normal use and service for a period of ninety days. There is no warranty accrual recorded because potential future payments either are not probable or we have yet to incur the expense.

**Note 7. Segment reporting and long-lived assets**

Insignia operates in a single industry segment, providing software technologies that enable mobile operators and phone manufacturers to update the firmware of mobile devices using standard over-the-air data networks. In the second quarter of 2004 one customer accounted for 98% of total revenues. In the three months ended June 30, 2005, one U.S. company accounted for 31% of total revenues, our Korean joint venture accounted for 26% of total revenues and one Spanish company accounted for 13% of total revenues. In the six months ended June 30, 2004, one customer accounted for 25% of our total revenues, and in the first six months of 2005 five customers accounted for 83% of total revenues with the largest accounting for 20% of total revenues. No other customers accounted for 10% or more of Insignia's total revenues during the three or six months ended June 30, 2005 and 2004. Sales to customers outside the United States, derived mainly from customers in Europe, the Middle East, Asia and Africa, represented approximately 69% and 81% of total revenues in the three and six months ended June 30, 2005, respectively, and approximately 100% and 65% of total revenues in the three and six months ended June 30, 2004, respectively. Revenue is attributed to countries based on customer location.

As of June 30, 2005, the majority of our long-lived assets are located outside the United States, principally in Sweden. All of our net intangible assets (\$2,290,000), goodwill (\$416,000) and other non-current assets (\$228,000) are located outside the United States. \$44,000 of our net fixed assets are located outside the United States. At December 31, 2004, substantially all of our long-lived assets were located in the United States.

**Note 8. Equity transactions and warrants**

On October 17, 2002, we entered into a securities subscription agreement with Fusion Capital Fund II, LLC ( Fusion Capital ), pursuant to which Fusion Capital agreed to purchase, on each trading day following the effectiveness of a registration statement covering the American Depositary Shares ( ADSs ) to be purchased by Fusion Capital, \$10,000 of our ADSs up to an aggregate of \$6.0 million over a period of 30 months. The purchase price of the ADSs was based on a formula based on the market price at the time of each purchase. In 2004, we sold 3,100,060 shares to Fusion Capital for aggregate proceeds of \$1.5 million, net of transaction costs, under the 2002 Fusion Capital securities subscription agreement. During 2003, we issued and sold to Fusion Capital 3,380,132 ADSs resulting in proceeds of \$1.9 million, net of transaction costs, under the 2002 Fusion Capital securities subscription agreement. In addition to the shares purchased by Fusion Capital under the 2002 Fusion Capital securities subscription agreement, we also issued warrants to purchase an aggregate of 2,000,000 shares to Fusion Capital, with a per share exercise price of the United States dollar equivalent of 20.5 pence. As of December 31, 2002, the estimated value of

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the warrants, using the Black-Scholes model was \$544,000. Upon Fusion's exercise of these warrants in 2003, we issued Fusion Capital 2,000,000 ADSs for a total of \$668,000, net of issuance costs.

On October 18, 2004, we closed a private placement financing with certain institutional and other accredited investors pursuant to which we sold 3,208,499 newly issued ADSs and warrants to purchase 802,127 additional ADSs at an exercise price of \$1.06, for a total purchase price of approximately \$1.5 million, or \$1.3 million net of transaction costs.

During January 2005, we sold 299,007 shares for \$200,000 under the 2002 Fusion Capital agreement. On February 9, 2005, Insignia sold to Fusion Capital 3,220,801 ADSs at a purchase price of \$0.40 per share, resulting in proceeds of approximately \$1.3 million. These shares were issued to Fusion Capital in a private placement.

On February 9, 2005, Insignia and Fusion Capital entered into a mutual termination agreement pursuant to which the 2002 Fusion Capital securities subscription agreement was terminated. As a result of this termination, the 2,000,000 shares issued on exercise of the warrants (described above) may be resold by Fusion Capital under the Company's existing S-1 registration statement.

On February 10, 2005, Insignia entered into a new securities subscription agreement with Fusion Capital to sell ADSs up to an aggregate of \$12 million to Fusion Capital over a period of 30 months (the 2005 Fusion Capital securities subscription agreement). The shares will be priced based on a market-based formula at the time of purchase. The commencement of funding under the 2005 Fusion Capital securities subscription agreement is subject to certain conditions, including the declaration of effectiveness by the Securities and Exchange Commission of a registration statement covering the ADSs to be purchased by Fusion Capital under the 2005 Fusion Capital securities subscription agreement. Under the rules and regulations of the Nasdaq SmallCap Market, the Company would be required to obtain shareholder approval to sell more than 19.99% of the issued and outstanding shares as of February 10, 2005 under this agreement. The timing of a registration statement covering the ADSs to be purchased by Fusion Capital being declared effective by the Securities and Exchange Commission is not within Insignia's control. Any delay in the commencement of funding under the 2005 Fusion Capital securities subscription agreement or in obtaining other funding could jeopardize Insignia's business. As a commitment fee for this facility Fusion Capital received warrants for 2,000,000 shares exercisable at the greater of £0.205 or \$0.40 per share and for 2,000,000 shares exercisable at £0.205 per share.

On March 16, 2005, we closed our acquisition of Mi4e Device Management AB (Mi4e), a private company headquartered in Stockholm, Sweden. The consideration paid in the transaction was 2,969,692 ADSs representing ordinary shares and another 989,896 ADSs will be issuable on March 31, 2006, subject to potential offset for breach of representations, warranties and covenants. In addition up to a maximum of 700,000 euros is payable in a potential earn out based on a percentage of future revenue collected from sales of existing Mi4e products. As of June 30, 2005, \$22,000 of this earn out has been earned.

In June 2005, the Company issued convertible notes to three shareholders in exchange for a bridge financing of \$275,000. These notes were converted into the Series A preferred stock described below on June 30, 2005. In consideration of this bridge financing the Company accrued loan fees in the form of ADSs representing 45,833 ordinary shares and warrants to purchase an aggregate of 45,833 ADSs at an exercise price of \$0.58 per share were issued; these shares were valued at a market value of \$25,200 and the warrants had a fair value, calculated using the Black-Scholes model, of approximately \$17,000.

On June 30, 2005 and July 5, 2005, we and our wholly-owned subsidiary Insignia Solutions Inc. (the Subsidiary) entered into Securities Subscription Agreements with Fusion Capital and other investors (each, an Investor and collectively, the Investors). Pursuant to these subscription agreements, Investors invested an aggregate of \$1,000,000 on June 30, 2005 (including exchange of the \$275,000 bridge notes), and we completed a second closing on July 5, 2005 for an additional \$440,400. Pursuant to these subscription agreements, the Subsidiary issued its Series A preferred stock, no par value per share to the Investors. The preferred stock is non-redeemable. The shares of preferred stock (plus all accrued and unpaid dividends thereon) held by each Investor are exchangeable for ADSs (i) at any time at the election of such Investor, (ii) automatically upon written notice by us to such Investor in the event that the sale price of the ADSs on the Nasdaq SmallCap Market is greater than \$1.50 per share for a period of ten consecutive trading days, and certain other conditions are met, and (iii) automatically to the extent any shares of the preferred

stock have not been exchanged prior to June 30, 2007. The preferred stock will accrue dividends for two years at a rate of 15% per year compounded annually, payable in the form of additional ADSs. Including accruable dividends, the shares of preferred stock issued on June 30, 2005, and the additional shares issued on July 5, 2005, will be exchangeable for 3,306,250 and 1,456,073 ADSs, respectively, at a fixed price of \$0.40 per ADS.

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Pursuant to the above subscription agreements, we also issued to the Investors on June 30, 2005 and July 5, 2005, warrants to purchase 2,500,000 and 1,101,000, ADSs respectively, at an exercise price per share equal to the greater of \$0.50 or the U.S. Dollar equivalent of 20.5 U.K. pence. These warrants are immediately exercisable and expire on June 30, 2010. We also entered into registration rights agreements with the Investors pursuant to which we agreed to file a registration statement with the Securities and Exchange Commission on or before August 31, 2005 covering the resale of (i) the ADSs issued to the Investors upon exchange of the Preferred Stock under their subscription agreements and (ii) the ADSs issuable upon exercise of their warrants.

The issuance of the Series A preferred stock resulted in a beneficial conversion feature, calculated in accordance with EITF No. 00-27, Application of Issue No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features of Contingently Adjustable Conversion Ratios to Certain Convertible Instruments based upon the conversion price of the preferred stock into ADSs, and the fair value of the ADSs at the date of issue. Accordingly, the warrants issued on June 30, 2005 were valued at \$585,000, using a Black-Scholes model and the Company recognized \$415,000 as a charge to additional paid-in-capital to account for the deemed dividend on the preferred stock, as of the issuance date, which represented the amount of the proceeds allocated to the preferred stock. The amount of the deemed dividend related to the beneficial conversion feature was recorded upon the issuance of the preferred stock, as the preferred stock can be converted to ADSs by the holder at any time.

The following table summarizes the warrant activity during the six months ended June 30, 2005.

|                            | <b>Warrants<br/>outstanding<br/>and exercisable</b> |    | <b>Warrants<br/>outstanding<br/>exercise price</b> |
|----------------------------|---|----|--|
| Balance, December 31, 2004 | 2,130,911   | \$ | 0.92 - \$5.00                                      |
| Granted                    | 6,738,355   |    | 0.37 - \$1.11(1)                                   |
| Exercised                  |   |    |  |
| Balance, June 30, 2005     | 8,869,266   | \$ | 0.37 - \$5.00(1)                                   |

(1) 2,000,000 of the warrants are exercisable at £0.205 (\$0.37 as of June 30, 2005), 2,000,000 at the greater of £0.205 or \$0.40 and 2,500,000 of the warrants are exercisable at the greater of £0.205 or \$0.50.

**Note 9. Related party transaction**

On March 16, 2005, we closed our acquisition of Mi4e. The consideration paid in the transaction was 2,969,692 ADSs representing ordinary shares and another 989,896 ADSs issuable on March 31, 2006, subject to potential offset for breach of representations, warranties and covenants. In addition up to a maximum of 700,000 Euros is payable in a potential earn out based on a percentage of future revenue collected from sales of existing Mi4e products. As of June 30, 2005, \$22,000 was earned. Anders Furehed, our senior vice president of European operations, was an indirect 50% shareholder of Mi4e and thus received 1,484,846 ADSs on the closing of the acquisition.

**Note 10. Notes payable**

With the March 16, 2005 acquisition of Mi4e, Insignia assumed two notes payable. The largest note is from ALMI Företags Partner ( ALMI ) and is referred to as a regional development loan . The total loan amount in Swedish Krona ( SEK ) was SEK 700,000 or approximately \$100,000. This note is to be repaid in equal monthly installments of approximately \$7,500. The interest rate on this note is 9.25% per annum. As of June 30, 2005, the outstanding balance of the ALMI note was approximately SEK 340,000 or \$44,000.

In addition to the ALMI note payable, there is a note payable from Skandinaviska Enskilda Banken ( SEB ). The total note amount was SEK 400,000 or approximately \$57,000. The interest rate on the SEB note is 6.75% per annum. As of June 30, 2005, the outstanding balance was SEK 158,000 or approximately \$20,000.

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

The following discussion and analysis should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in Part I Item 1 of this Form 10-Q and the Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Insignia's Form 10-K for the year ended December 31, 2004 (the Form 10-K) filed with the Securities and Exchange Commission.

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

The following table sets forth the unaudited condensed consolidated results of operations as a percentage of total revenues for the three- and six-month periods ended June 30, 2005 and 2004.

|                                | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|--------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                | <b>2005</b>               | <b>2004</b> | <b>2005</b>             | <b>2004</b> |
| Net revenues:                  |                           |             |                         |             |
| License                        | 68%                       | 98%         | 77%                     | 99%         |
| Service                        | 32                        | 2           | 23                      | 1           |
| Total net revenues             | 100                       | 100         | 100                     | 100         |
| Expenses:                      |                           |             |                         |             |
| Cost of revenues               | 13                        | 5           | 8                       | 7           |
| Sales and marketing            | 91                        | 494         | 111                     | 316         |
| Research and development       | 104                       | 618         | 133                     | 345         |
| General and administrative     | 96                        | 626         | 125                     | 296         |
| Amortization of intangibles    | 13                        |             | 9                       |             |
| Total operating expenses       | 317                       | 1,743       | 386                     | 964         |
| Operating loss                 | (217)                     | (1,643)     | (286)                   | (864)       |
| Interest income (expense), net | (6)                       | 3           | (3)                     |             |
| Other income (expense), net    | 5                         | 246         |                         | 59          |

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|   |        |          |        |        |
|---|--------|----------|--------|--------|
| Loss before income taxes                  | (218)  | (1,394)  | (289)  | (804)  |
| Provision for (benefit from) income taxes |        | (175)    | 3      | (50)   |
| Net loss                                  | (218)% | (1,219)% | (292)% | (754)% |

**Overview**

We commenced operations in 1986, and currently develop, market and support software technologies that enable mobile operators and phone manufacturers to update the firmware of mobile devices using standard over-the-air data networks. Before 2003, our principal product line was the Jeode platform, based on our Embedded Virtual Machine ( EVM ) technology.

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During 2001, we began development of a range of products ( Secure System Provisioning or SSP products) for the mobile phone and wireless operator industry. These SSP products build on our position as a Virtual Machine ( VM ) supplier for manufacturers of mobile devices and allow wireless operators and phone manufacturers to reduce customer care and software recall costs as well as increase subscriber revenue by deploying new mobile services based on dynamically provisional capabilities. With the sale of our JVM product line in April 2003, our sole product line then consisted of our SSP product. We shipped our first SSP product in December 2003, and in October 2004 we launched our Open Management Client ( OMC ) product.

On March 16, 2005, we closed our acquisition of Mi4e Device Management AB ( Mi4e ), a private company headquartered in Stockholm, Sweden. The consideration paid in the transaction was 2,969,692 American depositary shares (ADSs) representing ordinary shares, and another 989,896 ADSs are issuable on March 31, 2006, subject to potential offset for breach of representations, warranties and covenants. In addition, up to a maximum of 700,000 Euros is payable in a potential earn-out based on a percentage of future revenue collected from sales of existing Mi4e products. As of June 30, 2005, \$22,000 was earned. Mi4e develops, markets and supports software technologies that enable mobile operators and phone manufacturers to update firmware of mobile devices using standards over-the-air data networks. Its main product, a Device Management Server ( DMS ), is a mobile device management infrastructure solution for mobile operators that support the Open Mobile Alliance ( OMA ) Client Provisioning Specification. DMS was first deployed at Telstra in Australia in 2000 and has since been deployed at more than ten carriers around the world. By integrating the Mi4e capabilities with existing Insignia applications, our strategy is to deliver comprehensive solutions across multiple generations of technology and therefore resolve firmware update and compatibility issues for current and future users who require over-the-air repair.

Today we have the SSP, DMS and OMC product lines. Our revenues from these products are derived from:

initial licensing fees

royalties paid based on volume of users

support and maintenance fees

trial and installation

subscription fees for hosting services

engineering services

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

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

**Critical accounting policies and estimates**

The condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. Certain of our accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates. These estimates

affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. By their nature, these judgments are subject to an

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inherent degree of uncertainty. The most significant estimates and assumptions relate to revenue recognition, the valuation of long-lived assets and the adequacy of allowances for doubtful accounts. Actual amounts could differ from these estimates.

*Revenue recognition*

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

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

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

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

For arrangements with multiple obligations (for example, undelivered maintenance and support), we will allocate revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements, which is specific to us. This means that we will defer revenue equivalent to the fair value of the undelivered elements. Fair value for the ongoing maintenance and support obligation is based upon separate sales of renewals to other customers or upon renewal rates quoted in the contracts. Fair value of services, such as training or consulting, is based upon separate sales by us of these services to other customers.

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

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

*Accounts receivable and allowance for doubtful accounts*

We perform ongoing credit evaluations of our customers and will adjust credit limits based upon payment history and the customer s current credit worthiness, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers and maintain an allowance for estimated credit losses based upon historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within expectations and the allowance established, we cannot guarantee that

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we will continue to experience the same credit loss rates as in the past. Since our accounts receivable are concentrated in a relatively few number of customers, a significant change in the liquidity or financial position of any one of these customers could have a material adverse impact on the collectibility of accounts receivables and future operating results.

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

*Intangible Assets and Goodwill*

Consideration paid in connection with acquisitions is required to be allocated to the acquired assets, including identifiable intangible assets, and liabilities acquired. Acquired assets and liabilities are recorded based on an estimate of fair value, which requires significant judgment with respect to future cash flows and discount rates. For intangible assets other than goodwill, we are required to estimate the useful life of the asset and recognize its cost as an expense over the useful life. We are required to test intangible assets and goodwill for impairment under certain circumstances and write them down when they are deemed to be impaired. We have determined that our consolidated results comprise one reporting unit for the purpose of impairment testing.

As of June 30, 2005, we performed our test for impairment of intangible assets and goodwill as required by Statement of Financial Accounting Standards nos. 142 and 144.

*Accounting for the Impairment or Disposal of Long-Lived Assets*

We completed our evaluation for impairment of long-lived assets and concluded that they were not impaired because the fair value of Insignia's equity securities exceeded their carrying value. The amount of intangible assets and goodwill as of June 30, 2005 was \$2.3 million and \$0.4 million respectively. Future events could cause us to conclude that impairment indicators exist and that intangible assets and goodwill associated with our acquired business are impaired.

**Results of Operations***Revenues*

|                   | <b>Three months ended</b> |             | <b>Six months ended</b> |             |
|-------------------|---------------------------|-------------|-------------------------|-------------|
|                   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                   | <b>2005</b>               | <b>2004</b> | <b>2005</b>             | <b>2004</b> |
|                   | <i>(in thousands)</i>     |             | <i>(in thousands)</i>   |             |
| License revenue   | \$ 500                    | \$ 105      | \$ 917                  | \$ 421      |
| Service revenue   | 234                       | 2           | 279                     | 5           |
| Total net revenue | \$ 734                    | \$ 107      | \$ 1,196                | \$ 426      |

The SSP product line, which we launched in 2003, was expanded by our introduction of additional products in October 2004 and March 2005. These products include Open Management Client (OMC) and Device Management Server (DMS). The DMS product was acquired through the acquisition of Mi4E in March 2005. In 2005 our license revenues were from initial licensing fees and royalties and service fees came from support and maintenance, trials and installations, hosting services and engineering services. In 2004, revenues were derived from initial licensing fees, support and maintenance, and engineering services.

The 586% and 181% increase in total revenues from the three and six months ended June 30, 2004 to the same periods in 2005 was primarily due to six new operators becoming customers combined with the benefits of acquiring Mi4e in March 2005. License revenue and service revenue accounted for 68% and 32%, respectively, of total revenues in the second quarter of 2005 compared to 98% and 2% respectively in the same period of the prior year.

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The 376% increase in license revenues from the second quarter of 2004 to the second quarter of 2005 was primarily due to increased revenues from our SSP, and new in 2005, DMS, OMC, and DCS products and with the adoption of our products by a number of system operators. The SSP, DMS, OMC, and DCS products made up 31%, 32%, 31%, and 6%, respectively, of license revenues in the second quarter of 2005. In the second quarter of 2004, the SSP product line made up 100% of total license revenues.

The \$232,000 increase in service revenue from the second quarter of 2004 to the second quarter of 2005 was primarily due to the increase in agreements for set up, hosting, and support and maintenance services for the DMS and SSP products.

Sales to customers outside the United States, derived mainly from customers in Europe, the Middle East, Asia and Africa represented approximately 69% and 81% of total revenues in the three and six months ended June 30, 2005 and 100% and 65% of total revenues in the three and six months ended June 30, 2004.

*Expenses*

|                                   | Three months ended<br>June 30,        |        | Six months ended<br>June 30,          |          |
|-----------------------------------|---------------------------------------|--------|---------------------------------------|----------|
|                                   | 2005                                  | 2004   | 2005                                  | 2004     |
|                                   | (in thousands, except<br>percentages) |        | (in thousands, except<br>percentages) |          |
| Cost of net revenues              | \$ 94                                 | \$ 5   | \$ 99                                 | \$ 28    |
| Percentage of total revenues      | 13%                                   | 5%     | 8%                                    | 7%       |
| Sales and marketing               | \$ 667                                | \$ 529 | \$ 1,329                              | \$ 1,345 |
| Percentage of total revenues      | 91%                                   | 494%   | 111%                                  | 316%     |
| Research and development          | \$ 767                                | \$ 661 | \$ 1,591                              | \$ 1,472 |
| Percentage of total revenues      | 104%                                  | 618%   | 133%                                  | 345%     |
| General and administrative        | \$ 703                                | \$ 670 | \$ 1,484                              | \$ 1,261 |
| Percentage of total revenues      | 96%                                   | 626%   | 125%                                  | 296%     |
| Amortization of intangible assets | \$ 97                                 |        | \$ 110                                |          |
| Percentage of total revenues      | 13%                                   |        | 9%                                    |          |

Cost of net revenues consist of the cost of providing service revenue, primarily representing the cost of support and engineering for customer specific projects. In the three months ended June 30, 2005, cost of net revenues also included approximately \$60,000 for providing third party products to customers purchasing licenses. This accounted for most of the increase in cost of net revenues in the three and six months ended June 30, 2005.

Sales and marketing expenses consist primarily of personnel and related overhead costs, salespersons commissions, advertising and promotional expenses and expenses relating to trade shows. Sales and marketing expenses increased by 26% in the quarter ended June 30, 2005 from the quarter ended June 30, 2004. The increase was primarily due to salesperson severance costs, third party sales consultants, additional salespersons in Europe, offset in part by lower travel expenses. In the future we anticipate a moderate increase in sales and marketing expenses as we seek to increase our revenues.

Research and development costs consist primarily of personnel costs, professional consulting and travel expenses. Research and development expenses increased by 16% and 8% in the three and six months ended June 30, 2005, respectively, compared to the same period of 2004. This increase was primarily due to the addition of engineers from the Mi4e acquisition in March 2005. We anticipate, as a result of consolidation in the second quarter a modest decrease in research and development expenses.

General and administrative expenses consist primarily of personnel and related overhead costs for finance, information systems, human resources and general management. General and administrative expenses increased by 5% and 18% in the three and six months ended June 30, 2005 compared to the same period of 2004. The increases in the three and six months ended June 30, 2005 over the same period in the prior year is due to additional administrative costs associated with Mi4e which was acquired in March 2005 and an increase of \$175,000 in the reserve for doubtful accounts for two customers in Asia in the three months ended March 31, 2005.

Amortization of intangible assets in the three and six months ended June 30, 2005 represents the amortization of acquired customer relationships and technology from Mi4e which we purchased in March 2005.

**Table of Contents***Provision for (benefit from) income taxes*

|   | <b>Three months ended</b>          |             | <b>Six months ended</b>            |             |
|---|------------------------------------|-------------|------------------------------------|-------------|
|   | <b>June 30,</b>                    |             | <b>June 30,</b>                    |             |
|   | <b>2005</b>                        | <b>2004</b> | <b>2005</b>                        | <b>2004</b> |
|   | (in thousands, except percentages) |             | (in thousands, except percentages) |             |
| Provision for (benefit from) income taxes | \$                                 | \$ (187)    | \$ 36                              | \$ (213)    |
| Effective income tax rate                 | %                                  | 13%         | %                                  | 6%          |

Our benefit from income taxes of \$187,000 and \$213,000 for the three and six months ended June 30, 2004 primarily represented a refund received from the United Kingdom for research and development claims. We have recorded a full valuation allowance against all deferred tax assets, primarily comprised of net operating losses, on the basis that significant uncertainty exists with respect to their realization.

*Liquidity and capital resources*

|  | <b>June 30, 2005</b> | <b>December 31, 2004</b> |
|--|----------------------|--------------------------|
|  | (in thousands)       |                          |
| Cash, cash equivalents and restricted cash | \$ 892               | \$ 952                   |
| Working capital (deficit)                  | \$ (222)             | \$ 900                   |

Cash used in operating activities in the six months ended June 30, 2005 totaled \$2,375,000 compared to \$2,673,000 for the same period in 2004. For the six months ended June 30, 2005, cash used in operating activities resulted primarily from a net loss of \$3,489,000, and an increase in accounts receivable of \$496,000, partially offset by a decrease in other receivables and prepaid expenses of \$583,000 and an increase of accounts payable and accruals of \$644,000 and decrease of deferred revenue of \$113,000.

Cash provided by investing activities for the six months ended June 30, 2005 was \$189,000, which consisted of cash received with the purchase of Mi4e of \$303,000 net acquisition costs of \$102,000, less \$12,000 for the purchase of fixed assets.

Cash provided by financing activities for the six months ended June 30, 2005 was \$2,126,000, resulting from share issuances to investors with net proceeds of \$2,081,000, and proceeds from exercise of stock options and employee stock purchase plan of \$89,000, less \$44,000 for repayment of notes payable.

Our cash, cash equivalents and restricted cash were \$892,000 at June 30, 2005, a decrease of \$60,000 from \$952,000 at December 31, 2004. At June 30, 2005 and December 31, 2004, we had a working capital deficit of \$222,000 and a surplus of \$900,000, respectively. The working capital deficit arose from the Company's operating losses in the six months ended June 30, 2005 exceeding cash equity investments in the Company during the period. The principal use of working capital was funding the operating loss and financing of account receivable. We have no material commitments for capital expenditures. Our commitments for expenditures consist of building leases in the U.K. and U.S.

As of June 30, 2005, we had the following contractual cash obligations (in thousands):

|  | <b>Operating Leases</b> |
|--|-------------------------|
| Year ending December 31, 2005 (July 1, 2005 through December 31, 2005) | \$ 107                  |
| 2006   | 122                     |
| 2007   | 95                      |
| 2008   | 95                      |
| 2009   | 95                      |
| Thereafter   | 918                     |

\$ 1,432

As of June 30, 2005, we had note payable commitments totalling approximately \$64,000.

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As of June 30, 2005, three customers accounted for 82% of our net accounts receivable.

During January 2005, we sold 299,007 shares for \$200,000 under the 2002 Fusion Capital agreement. On February 9, 2005, Insignia sold to Fusion Capital 3,220,801 ADSs at a purchase price of \$0.40 per share, resulting in proceeds of approximately \$1.3 million. These shares were issued to Fusion Capital in a private placement.

On February 9, 2005, Insignia and Fusion Capital entered into a mutual termination agreement pursuant to which the 2002 Fusion Capital securities subscription agreement was terminated. As a result of this termination, the 2,000,000 shares issued on exercise of the warrants (described above) may be resold by Fusion Capital under the Company's existing S-1 registration statement.

On February 10, 2005, Insignia entered into a new securities subscription agreement with Fusion Capital to sell ADSs up to an aggregate of \$12 million to Fusion Capital over a period of 30 months (the 2005 Fusion Capital securities subscription agreement). The shares will be priced based on a market-based formula at the time of purchase. The commencement of funding under the 2005 Fusion Capital securities subscription agreement is subject to certain conditions, including the declaration of effectiveness by the Securities and Exchange Commission of a registration statement covering the ADSs to be purchased by Fusion Capital under the 2005 Fusion Capital securities subscription agreement. Under the rules and regulations of the Nasdaq SmallCap Market, the Company would be required to obtain shareholder approval to sell more than 19.99% of the issued and outstanding shares as of February 10, 2005 under this agreement. The timing of a registration statement covering the ADSs to be purchased by Fusion Capital being declared effective by the Securities and Exchange Commission is not within Insignia's control. Any delay in the commencement of funding under the 2005 Fusion Capital securities subscription agreement or in obtaining other funding could jeopardize Insignia's business. As a commitment fee for this facility Fusion received warrants for 2,000,000 shares exercisable at the greater of £0.205 or \$0.40 per share and for 2,000,000 shares exercisable at £0.205 per share.

On March 16, 2005, we closed our acquisition of Mi4e Device Management AB (Mi4e), a private company headquartered in Stockholm, Sweden. The consideration paid in the transaction was 2,969,692 ADSs representing ordinary shares and another 989,896 ADSs will be issuable on March 31, 2006, subject to potential offset for breach of representations, warranties and covenants. In addition up to a maximum of 700,000 euros is payable in a potential earn out based on a percentage of future revenue collected from sales of existing Mi4e products. As of June 30, 2005, \$22,000 of this earn out was earned.

In June 2005, the Company issued convertible notes to three shareholders in exchange for a bridge financing of \$275,000. These notes were converted into the Series A preferred stock described below on June 30, 2005. In consideration of this bridge financing the Company accrued loan fees in the form of ADSs representing 45,833 ordinary shares and warrants to purchase an aggregate of 45,833 ADSs at an exercise price of \$0.58 per share were issued; these shares were valued at a market value of \$25,200 and the warrants had a fair value, calculated using the Black-Scholes model, of approximately \$17,000.

On June 30, 2005 and July 5, 2005, we and our wholly-owned subsidiary Insignia Solutions Inc. (the Subsidiary) entered into Securities Subscription Agreements with Fusion Capital and other investors (each, an Investor and collectively, the Investors). Pursuant to these subscription agreements, Investors invested an aggregate of \$1,000,000 on June 30, 2005 (including exchange of the \$275,000 bridge notes), and we completed a second closing on July 5, 2005 for an additional \$440,400. Pursuant to these subscription agreements, the Subsidiary issued its Series A preferred stock, no par value per share to the Investors. The preferred stock is non-redeemable. The shares of preferred stock (plus all accrued and unpaid dividends thereon) held by each Investor are exchangeable for ADSs (i) at any time at the election of such Investor, (ii) automatically upon written notice by us to such Investor in the event that the sale price of the ADSs on the Nasdaq SmallCap Market is greater than \$1.50 per share for a period of ten consecutive trading days, and certain other conditions are met, and (iii) automatically to the extent any shares of the preferred stock have not been exchanged prior to June 30, 2007. The preferred stock in the first two years will accrue dividends at a rate of 15% per year compounded annually, payable in the form of additional ADSs. Including accruable dividends, the shares of preferred stock issued on June 30, 2005, and the additional shares issued on July 5, 2005, will be exchangeable for 3,306,250 and 1,456,073 ADSs, respectively, at a fixed price of \$0.40 per ADS.

Pursuant to the above subscription agreements, we also issued to the Investors on June 30, 2005 and July 5, 2005, warrants to purchase 2,500,000 and 1,101,000, ADSs respectively, at an exercise price per share equal to the greater of \$0.50 or the U.S. Dollar equivalent of 20.5 U.K. pence. These warrants are immediately exercisable and expire on June 30, 2010. We also entered into registration rights agreements with the Investors pursuant to which we agreed to file a registration statement with the Securities and Exchange Commission on or before August 31, 2005 covering the resale of (i) the ADSs issued to the Investors upon exchange of the Preferred Stock under their subscription agreements and (ii) the ADSs issuable upon exercise of their warrants.

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ADSs issued to the Investors upon exchange of the Preferred Stock under their subscription agreements and (ii) the ADSs issuable upon exercise of their warrants.

The issuance of the Series A preferred stock resulted in a beneficial conversion feature, calculated in accordance with EITF No. 00-27, Application of Issue No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features of Contingently Adjustable Conversion Ratios to Certain Convertible Instruments based upon the conversion price of the preferred stock into ADSs, and the fair value of the ADSs at the date of issue. Accordingly, the warrants issued on June 30, 2005 were valued at \$585,000 (using a Black-Scholes model) and the Company recognized \$415,000 as a charge to additional paid-in-capital to account for the deemed dividend on the preferred stock as of the issuance date, which represented the amount of the proceeds allocated to the preferred stock. The amount of the deemed dividend related to the beneficial conversion feature was recorded upon the issuance of the preferred stock, as the preferred stock can be converted to ADSs by the holder at any time.

If cash currently available from all sources is insufficient to satisfy our liquidity requirements, we may seek additional sources of financing, including selling additional equity or debt securities. If additional funds are raised through the issuance of equity or debt securities, these securities could have rights, preferences and privileges senior to holders of our shares, and the terms of such securities could impose restrictions on our operations. The sale of additional equity or debt securities could result in additional dilution to our shareholders. We may not be able to obtain additional financing on acceptable terms, if at all. If we are unable to obtain additional financing as and when needed and on acceptable terms, we may be required to reduce the scope of our planned sales, marketing and product development efforts, which could jeopardize our business.

**New Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004) Share-Based Payment ( SFAS 123R ), a revision to SFAS 123. SFAS 123R addresses all forms of share-based payment ( SBP ) awards, including shares issued under the 1995 Incentive Stock Option Plan ( Purchase Plan ), stock options, restricted stock, restricted stock units and stock appreciation rights. SFAS 123R will require the Company to record compensation expense for SBP awards based on the fair value of the SBP awards. Under SFAS 123R, restricted stock and restricted stock units will generally be valued by reference to the market value of freely tradable shares of the Company's ordinary shares. Stock options, stock appreciation rights and shares issued under the Purchase Plan will generally be valued at fair value determined through an option valuation model, such as a lattice model or the Black-Scholes model (the model that Insignia currently uses for its footnote disclosure). SFAS 123R is effective for annual periods beginning after June 15, 2005 and, accordingly, Insignia must adopt the new accounting provisions effective January 1, 2006. The Company will adopt the provisions of SFAS 123R using a modified prospective application. Under a modified prospective application, SFAS 123R will apply to new awards and to awards that are outstanding on the effective date and are subsequently modified or cancelled.

Compensation expense for outstanding awards for which the requisite service had not been rendered as of the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under SFAS 123. The Company is in the process of determining how the new method of valuing stock-based compensation as prescribed in SFAS 123R will be applied to valuing stock-based awards granted after the effective date and the impact the recognition of compensation expense related to such awards will have on its consolidated financial statements.

In June 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements ( SFAS 154 ). SFAS 154 will require companies to account for and apply changes in accounting principles retrospectively to prior periods' financial statements, instead of recording a cumulative effect adjustment within the period of the change, unless it is impracticable to determine the effects of the change to each period being presented. SFAS 154 is effective for accounting changes made in annual periods beginning after December 15, 2005 and, accordingly, we must adopt the new accounting provisions effective January 1, 2006. We do not expect the adoption of SFAS 154 to have a material effect on our financial position, results of operations or cash flows.

**Risk Factors**

In addition to the other information in this report, the following factors should be considered carefully in evaluating our business and prospects:

**We may need additional financing to sustain our operations, and we may not be able to continue to operate as a going concern.**

In the six months ended June 30, 2005 we had a net loss of \$3.5 million and had net cash used in operations of \$2.4 million. We had cash, cash equivalents, and restricted cash of \$0.9 million at June 30, 2005. In addition, we had recurring net losses of \$7.1 million, \$4.3 million, and \$8.4 million for the years ended December 31, 2004, 2003, and 2002, respectively, and we also had net cash used in operations of \$7.6 million, \$4.2 million, and \$8.4 million for the years ended December 31, 2004, 2003, and 2002, respectively. These conditions raise substantial doubt about our ability to continue as a going concern.

Based upon our current forecasts and estimates, including the closing of the 2005 Fusion Capital securities subscription agreement in the third quarter of 2005 and the achievement of our target revenues, cost-cutting and accounts receivable collection goals, our current forecasted cash and cash equivalents should be sufficient to meet our operating and capital requirements. If cash currently available from all sources is insufficient to satisfy our liquidity requirements, we may seek additional sources of financing including selling additional equity or debt securities. If additional funds are raised through the issuance of equity or convertible debt

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securities, the percentage ownership of our shareholders would be reduced, and our shareholders could experience substantial dilution. In addition, any equity or debt securities could have rights, preferences and privileges senior to holders of our shares, and the terms of such securities could impose restrictions on our operations. The sale of additional equity or debt securities could result in additional dilution to our shareholders. We may not be able to obtain additional financing on acceptable terms, if at all. If we are unable to obtain additional financing as and when needed and on acceptable terms our business may be jeopardized.

On February 10, 2005, Insignia entered into a new securities subscription agreement with Fusion Capital to sell ADSs, representing ordinary shares having an aggregate purchase price of up to \$12.0 million, to Fusion Capital over a period of 30 months. The shares will be priced based on a market-based formula at the time of purchase. The commencement of funding under the 2005 Fusion Capital securities subscription agreement is subject to the declaration of effectiveness by the Securities and Exchange Commission of a registration statement covering the ADSs to be purchased by Fusion Capital under the 2005 Fusion Capital securities subscription agreement. Any delay in the commencement of funding under the 2005 Fusion Capital securities subscription agreement could jeopardize Insignia's business.

We only have the right to receive \$20,000 per trading day under the agreement with Fusion Capital unless our stock price equals or exceeds \$1.00, in which case the daily amount may be increased under certain conditions as the price of our ADSs increases. Fusion Capital shall not have the right nor be obligated to subscribe for any ADSs on any trading days that the market price of our ADSs is less than \$0.40. Under the laws of England and Wales, we are not permitted to sell our ADSs at a purchase price that is less than the nominal value of our ordinary shares. Currently, the nominal value per ordinary share is £0.20. In addition, Insignia will not effect any issuance of ordinary shares (or have its transfer agent or depository issue any ADSs) on any trading day where the purchase price for any subscriptions would be less than the U.S. dollar equivalent of 102.5% of the then nominal value of the ordinary shares.

We have a total of 75,000,000 shares authorized for issuance, of which 42,433,025 shares were outstanding as of June 30, 2005, 12,722,966 shares were reserved for issuance upon the exercise of outstanding warrants and options and 8,440,395 shares were reserved in connection with the June 30 and July 5, 2005 Securities Subscription Agreements. Accordingly, we have a total of 11,403,614 shares currently available and authorized for issuance in connection with future financing and strategic transactions. We are planning to seek authorization to issue additional shares at our upcoming annual general shareholders meeting in September 2005. There can be no assurance that shareholders will vote to approve this increase in our authorized shares, and if they do not approve such increase, our ability to complete equity financing transactions will be significantly limited.

Because we are registering 20,000,000 shares for sale by Fusion Capital (of which 4,000,000 shares are purchasable on exercise of warrants issued to Fusion Capital), the selling price of our ADSs to Fusion Capital will have to average at least \$0.75 per share for us to receive the maximum proceeds of \$12,000,000.

Assuming an average purchase price of \$0.47 per share (the closing sale price of the ADSs on August 1, 2005) and the purchase by Fusion Capital of 16,000,000 ADSs under the 2005 securities subscription agreement, proceeds to us would be \$7,520,000, plus up to approximately \$1,540,000 from exercise of warrants. In addition, even if we are able to access the full \$12,000,000 under the 2005 securities subscription agreement with Fusion Capital, we may still need additional capital to implement our business, operating and development plans. Should the financing we require to sustain our working capital needs be unavailable or prohibitively expensive when we require it, our business could be jeopardized.

**Our stock could be delisted from Nasdaq.**

The Company has received a Nasdaq Staff Determination indicating that the Company was not, at December 31, 2004, in compliance with the stockholders' equity requirement for continued listing set forth in MarketPlace Rule 4310(c)(2)(B) and that its securities were, therefore, subject to delisting from the Nasdaq SmallCap Market. The Company had a hearing scheduled before a Nasdaq Listing Qualifications Panel to review the Staff Determination, which was subsequently cancelled because as of March 31, 2005 the Company's shareholders' equity exceeded

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\$2,500,000. There is no assurance that the Company will be able to continue to maintain stockholders' equity of at least \$2,500,000 as required for continued listing on the Nasdaq SmallCap Market.

**The sale of our shares to Fusion Capital will cause dilution, and the sale of shares by Fusion Capital and others could cause the price of our shares to decline.**

The number of shares to be issued to Fusion Capital pursuant to the 2005 securities subscription agreement with Fusion Capital will fluctuate based on the price of our shares. Shares sold to Fusion Capital under the 2005 securities subscription agreement will be freely tradable from the effective date of the registration statement filed in connection with the transaction. Fusion Capital may sell none, some or all of the shares purchased from us at any time. We expect that the shares to be sold to Fusion Capital will be sold over a period of up to 30 months from the effective date of the registration statement filed in connection with the transaction.

In addition, we plan to register for resale the shares issued and issuable in connection with our October 2004 and our 2005 private placement transactions and the Mi4e acquisition. Depending upon market liquidity at the time, a sale of such shares at any given time could cause the trading price of our shares to decline. The sale of a substantial number of shares, or anticipation of such sales, could make it more difficult for us to sell equity or equity-related securities in the future at a time and at a price that we might otherwise wish to effect sales.

**We have achieved minimal sales of our products to date.**

Our future performance depends upon sales of our SSP, DMS and OMC product lines. We began shipping the SSP product in December 2003 and the OMC product line in October 2004. We have achieved only minimal sales to date, including revenues of only \$450,000 relating to sales of the SSP product in 2004. The DMS product line was acquired as part of Mi4e in March 2005 and we thus have limited experience in selling this product. If we are unable to gain the necessary customer acceptance of our products, our business may be jeopardized.

Our SSP and OMS products represent the next-generation products that enable carriers to repair and update mobile phones over-the-air without having their customers send back their handsets to the carrier for repair or update. To the extent that carriers continue to use the current generation of over-the-air products, such as those offered by Bitfone, Innopath, Openwave and mFormation, to make repairs and updates and do not believe that the next generation products, such as our SSP product, offer a sufficiently important improvement at a reasonable cost, then we may not achieve our targeted sales and our business could fail. Conversely, our newly acquired DMS product represents the current generation of technology.

In addition, some prospective customers have been reticent to buy our products because of our current financial position. To the extent that prospective customers believe that we are under-capitalized, they may be hesitant to buy our products.

**The long and complex process of licensing our products makes our revenue unpredictable.**

Our revenue is dependent upon our ability to license our products to third parties. Licensing our products has to date been a long and complex process, typically being a six to nine months sales cycle. Before committing to license our products, potential customers must generally consider a wide range of issues including product benefits, infrastructure requirements, functionality, reliability and our ability to work with existing systems. The process of entering into a development license with a company typically involves lengthy negotiations. Because of the sales cycle, it is difficult for us to predict when, or if, a particular prospect might sign a license agreement. License fees may be delayed or reduced because of this process.

**We rely on third parties for software development tools, which we distribute with some of our products.**

We license software development tool products from other companies to distribute with some of our products. These third parties may not be able to provide competitive products with adequate features and high quality on a timely basis or to provide sales and marketing cooperation. Furthermore, our products compete with products produced by some of our licensors. When these licenses terminate or expire, continued license rights might not be available to us on reasonable terms, or at all. We might not be able to obtain similar products to substitute into our tool suites.

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**If handset manufacturers (and other third parties) do not achieve substantial sales of their products that incorporate our technology, we will not receive royalty payments on our licenses.**

Our success depends upon the use of our technology by our licensees in their smart devices. Our licensees undertake a lengthy process of developing systems that use our technology. Until a licensee has sales of its systems incorporating our technology, they are not obligated to pay us royalties. We expect that the period of time between entering into a development license and actually recognizing commercial use royalties will be lengthy and difficult to predict.

**We have a history of losses and we must generate significantly greater revenue if we are to achieve profitability.**

We have experienced operating losses in each quarter since the second quarter of 1996. To achieve profitability, we will have to increase our revenue significantly. Our ability to increase revenue depends upon the success of our products, and to date we have received only minimal revenue. If we are unable to create revenue in the form of development license fees, maintenance and support fees, commercial use royalties and nonrecurring engineering services, our current revenue will be insufficient to sustain our business.

**We need to increase our sales and marketing expenditures in order to achieve sales of our products; however, this increase in expenses is expected to decrease our cash position.**

In the three and six months ended June 30, 2005, we spent 91% and 111%, respectively, of our total revenues on sales and marketing. We expect to continue to incur disproportionately high sales and marketing expenses in the future. To market our products effectively, we must develop client and server channel markets. We will continue to incur the expenses for a sales and marketing infrastructure before we recognize significant revenue from sales of the product. Because customers in the smart device market tend to remain with the same vendor over time, we believe that we must devote significant resources to each potential sale. If potential customers do not design our products into their systems, the resources we have devoted to the sales prospect would be lost. If we fail to achieve and sustain significant increases in our quarterly sales, we may not be able to continue to increase our investment in these areas. With increased expenses, we must significantly increase our revenue if we are to become profitable.

**If we are unable to stay abreast of technological changes, evolving industry standards and rapidly changing customer requirements, our business reputation will likely suffer and revenue may decline.**

The market for mobile devices is fragmented and characterized by technological change, evolving industry standards and rapid changes in customer requirements. Our products will need to be continually improved to meet emerging market conditions, such as new interoperability standards, new methods of wireless notifications, new flash silicon technologies and new telecom infrastructure elements. Our existing products will become less competitive or obsolete if we fail to introduce new products or product enhancements that anticipate the features and functionality that customers demand. The success of our new product introductions will depend on our ability to:

accurately anticipate industry trends and changes in technology standards;

complete and introduce new product designs and features in a timely manner;

continue to enhance our existing product lines; and

respond promptly to customers requirements and preferences.

Development delays are commonplace in the software industry. We have experienced delays in the development of new products and the enhancement of existing products in the past and are likely to experience delays in the future. We may not be successful in developing and marketing, on a timely basis or at all, competitive products, product enhancements and new products that respond to technological change, changes in customer requirements and emerging industry standards.

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**Our targeted market is highly competitive.**

Our products are targeted for the mobile operator and mobile device market. The market for these products is fragmented and highly competitive. This market is also rapidly changing, and there are many companies creating products that compete or will compete with ours. As the industry develops, we expect competition to increase in the future. This competition may come from existing competitors or other companies that we do not yet know about. Our main competitors include Bitfone, IBM, InnoPath, 4thPass, mFormation, Openwave and Red Bend.

If these competitors develop products that are less expensive or provide better capabilities or functionality than do our products, we will be unable to gain market share. Many of our current competitors and potential competitors have greater resources, including larger customer bases and greater financial resources than we do, and we might not be able to compete successfully against these companies. A variety of other potential actions by our competitors, including increased promotion and accelerated introduction of new or enhanced products, could also harm our competitive position.

**Our revenue model may not succeed.**

Competition could force us to reduce the prices of our products, which would result in reduced gross margins and could harm our ability to provide adequate service to our customers and our business. Our pricing model for our software products is a combination of (1) initial license fees, (2) royalties, (3) support and maintenance fees, (4) trials and installations (5) hosting services and (6) engineering service fees, any of which may be subject to significant pricing pressures. Also, the market may demand alternative pricing models in the future, which could decrease our revenues and gross margins.

**Fluctuations in our quarterly results could cause the market price of our shares to decline.**

Our quarterly operating results can vary significantly depending on a number of factors. These factors include:  
the volume and timing of orders received during the quarter;

the mix of and changes in customers to whom our products are sold;

the mix of product and service revenue received during the quarter;

the mix of development license fees and commercial use royalties received;

the timing and acceptance of new products and product enhancements by us or by our competitors;

changes in product pricing;

foreign currency exchange rate fluctuations; and

ability to recognize revenue on orders received.

All of these factors are difficult to forecast. Our future operating results may fluctuate due to these and other factors, including our ability to continue to develop innovative and competitive products. Due to all of these factors, we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be viewed as an indication of our future performance.

**We have engineering and other operations both in the United States and foreign countries, which is expensive and can create logistical challenges.**

We currently have 14 employees in the United States, 8 employees in the United Kingdom and 15 employees in Sweden. In the past, the geographic distance between our engineering personnel in the United Kingdom and our principal offices in California and primary markets in Asia, Europe and the United States has led to logistical and communication difficulties. In the future, we may experience similar difficulties, which may have an adverse impact on our business. Further, because a substantial portion of our research and development operations is located in the

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United Kingdom and Sweden, our operations and expenses are directly affected by economic and political conditions in the United Kingdom and Sweden.

Economic conditions in Europe and fluctuations in the value of the U.S. dollar against the Euro, Swedish Krona and British pound sterling could impair our revenue and results of operations. International operations are subject to a number of other special risks. These risks include foreign government regulation, reduced protection of intellectual property rights in some countries where we do business, longer receivable collection periods and greater difficulty in accounts receivable collection, unexpected changes in, or imposition of, regulatory requirements, tariffs, import and export restrictions and other barriers and restrictions, potentially adverse tax consequences, the burdens of complying with a variety of foreign laws and staffing and managing foreign operations, general geopolitical risks, such as political and economic instability, hostilities with neighboring countries and changes in diplomatic and trade relationships, and possible recessionary environments in economies outside the United States.

In March 2005, we acquired Mi4e Device Management, AB, a company headquartered in Sweden. We now have 15 employees and an office in Sweden. It takes substantial management time and financial resources to integrate operations in connection with an acquisition, and the potential logistical, personnel and customer challenges are exacerbated when, as in this case, the acquirer and target company are separated by great geographic distance.

**International sales of our products, which we expect to comprise a significant portion of total revenue, expose us to the business and economic risks of international operations.**

Sales from outside of the United States accounted for approximately 81% and 65% of our total revenue for the six months ended June 30, 2005 and June 30, 2004, respectively. We expect to market SSP, DMS and OMC to mobile operators and handset manufacturers in Europe. Economic conditions in Europe and fluctuations in the value of the Euro, British pounds sterling and Swedish Krona against the U.S. dollar could impair our revenue and results of operations. International operations are subject to a number of other risks. These risks include:

longer receivable collection periods and greater difficulty in accounts receivable collection;

foreign government regulation;

reduced protection of intellectual property rights in some countries where we do business;

unexpected changes in, or imposition of, regulatory requirements, tariffs, import and export restrictions and other barriers and restrictions;

potentially adverse tax consequences;

the burdens of complying with a variety of foreign laws and staffing and managing foreign operations;

general geopolitical risks, such as political and economic instability, terrorism, hostilities with neighboring countries and changes in diplomatic and trade relationships; and

possible recessionary environments in economies outside the United States.

**Our technology depends on the adoption of standards such as those set forth by the Open Mobile Alliance ( OMA ). If such standards are not effectively established our business could suffer. Use of open industry standards, however, may also make us more vulnerable to competition.**

We promote open standards in our technology in order to support open competition and interoperability. We do not exercise control over the development of open standards. Our products are integrated with communication service providers' systems and mobile phones. If we are unable to continue to successfully integrate our platform products with these third-party technologies, our business could suffer. In addition, large wireless operators sometimes create detailed service specifications and requirements, such as Vodafone Live or DoCoMo iMode, and such operators are not required to share those specifications with us. Failure or delay in the creation of open, global specifications could have a negative impact on our sales and operating results.

The widespread adoption of open industry standards, however, may make it easier for new market entrants and existing competitors to introduce products that compete with our software products.

**Table of Contents****Product defects can be expensive to fix and may cause us to lose customers.**

The software we develop is complex and must meet the stringent technical requirements of our customers. We must develop our products quickly to keep pace with the rapidly changing Internet software and telecommunications markets. Software products and services as complex as ours are likely to contain undetected errors or defects. Software errors are particularly common when a product is first introduced or a new version is released. Despite thorough testing, our products might be shipped with errors. If this were to happen, customers could reject our products, or there might be costly delays in correcting the problems, and we could face damage to our reputation. Our products are increasingly used in systems that interact directly with the general public, such as in transportation and medical systems. In these public-facing systems, the failure of our product could cause substantial property damage or personal injury, which could expose us to product liability claims. Our products are used for applications in business systems where the failure of our product could be linked to substantial economic loss. Our agreements with our customers typically contain provisions designed to limit our exposure to potential product liability and other claims. It is likely, however, that these provisions are not effective in all circumstances and in all jurisdictions. We may not have adequate insurance against product liability risks, and renewal of our insurance may not be available to us on commercially reasonable terms. Further, our errors and omissions insurance may not be adequate to cover claims. If we ever had to recall our product due to errors or other problems, it would cost us a great deal of time, effort and expense.

Our operations depend on our ability to protect our computer equipment and the information stored in our databases against damage by fire, natural disaster, power loss, telecommunications failure, unauthorized intrusion and other catastrophic events. The measures we have taken to reduce the risk of interruption in our operations may not be sufficient. As of the date of this report, we have not experienced any major interruptions in our operations because of a catastrophic event.

**If we lose key personnel or are unable to hire additional qualified personnel as necessary, we may not be able to successfully manage our business or sell our products.**

Our future performance depends to a significant degree upon the continued contributions of our key management, product development, sales, marketing and operations personnel. We do not have agreements with any of our key personnel that obligates them to work for us for a specific term, and we do not maintain any key person life insurance policies. We currently intend to hire additional salespeople and believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales, marketing and operations personnel, many of whom are in great demand. Competition for qualified personnel can be intense in the San Francisco Bay Area, where our U.S. operations are headquartered.

**Our performance depends significantly on our ability to protect our intellectual property and proprietary rights in the technologies used in our products. If we are not adequately protected, our competitors could use the technologies that we have developed to enhance their products and services, which could harm our business.**

We rely on a combination of patent, copyright, trademark, trade secret laws, confidentiality provisions and other contractual provisions to protect our intellectual property and proprietary rights, but these legal means afford only limited protection. Despite the measures we take to protect our intellectual property rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information which we regard as proprietary. In addition, the laws of some countries may not protect our intellectual property and proprietary rights as fully as do the laws of the United States. Thus, the measures we take to protect our intellectual property and proprietary rights in the United States and abroad may not be adequate. In addition, our competitors may independently develop similar technologies.

The market for wireless communications and the delivery of Internet-based services are characterized by the existence of a large number of patents and frequent litigation based on allegations of patent infringement. As the number of entrants into our market increases, the possibility of infringement claims against us grows. In addition, because patents can take many years to issue, there may be one or more patent applications now pending of which we are unaware, and which we may be accused of infringing when patent(s) are issued from the application(s) in the

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future. To address any patent infringement claims, we may need to enter into royalty or licensing agreements on disadvantageous commercial terms. We may also have to incur significant legal expenses to ascertain the risk of infringing a patent and the likelihood of that patent being valid. A successful claim of patent infringement against us, and our failure to license the infringing or similar technology, could harm our business. In addition, any infringement claims, with or without merit, would be time consuming and expensive to litigate or settle and could divert management attention from administering our core business.

As a member of several groups involved in setting standards for the industry, we have agreed to license our intellectual property to other members of those groups on fair and reasonable terms to the extent that the intellectual property is essential to implementing the specifications promulgated by those groups. Each of the other members of the groups has agreed to similar provisions.

**Our products may infringe the intellectual property rights of third parties, which may result in lawsuits and prevent us from selling our products.**

As the number of patents, copyrights, trademarks and other intellectual property rights in our industry increases, products based on our technology may increasingly become the subject of infringement claims. Third parties could assert infringement claims against us in the future. For example, other companies have asked us to evaluate the need for a license of patents they hold, and we cannot assure you that patent infringement claims will not be filed against us in the future. Infringement claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require us to enter into royalty or licensing agreements. Royalty or licensing agreements, if required, might not be available on terms acceptable to us. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Litigation to determine the validity of any claims, whether or not the litigation is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel from productive tasks. If there is an adverse ruling against us in any litigation, we may be required to pay substantial damages, discontinue the use and sale of infringing products, expend significant resources to develop non-infringing technology or obtain licenses to infringing technology. Our failure to develop or license a substitute technology could prevent us from selling our products.

**We are at risk of securities litigation which, regardless of the outcome, could result in substantial costs and divert management attention and resources.**

Stock market volatility has had a substantial effect on the market prices of securities issued by us and other high technology companies, often for reasons unrelated to the operating performance of the specific companies. Following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against high technology companies. We have in the past been, and may in the future be, the target of similar litigation. Regardless of the outcome, securities litigation may result in substantial costs and divert management attention and resources.

**If we are unable to favorably assess the effectiveness of our internal controls over financial reporting, or if our independent auditors are unable to provide an unqualified attestation report on our assessment our stock price could be adversely affected.**

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 and beginning with our Annual Report on Form 10-K for the year ending December 31, 2006, our management will be required to report on, and our independent auditors to attest to, the effectiveness of our internal controls over financial reporting. The rules governing the standards that must be met for management to assess our internal controls over financial reporting are new and complex, and require significant documentation, testing and possible remediation. The process of reviewing, documenting and testing our internal controls over financial reporting, will result in substantial increased expenses and the devotion of significant management and other internal resources.

We may encounter problems or delays in completing the assessment and the implementation of any changes necessary to make a favorable assessment of our internal controls over financial reporting, including having the necessary financial resources to conduct the assessment and implementation. If we cannot favorably assess the effectiveness of our internal controls over financial reporting, or if our independent auditors are unable to provide an unqualified attestation report on our assessment, investor confidence and our stock price could be adversely affected.



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**Our investors may have difficulty enforcing judgments against us in U.S. courts because many of our assets and some of our directors and management are located in England and Sweden.**

Insignia is incorporated under the laws of England and Wales. Two of our directors reside in England. All or a substantial portion of the assets of these persons, and a portion of our assets, are located outside of the United States. It may not be possible for investors to serve a complaint within the United States upon these persons or to enforce against them or against us, in U.S. courts, judgments obtained in U.S. courts based upon the civil liability provisions of U.S. securities laws. There is doubt about the enforceability outside of the United States, in original actions or in actions for enforcement of judgments of U.S. courts, of civil liabilities based solely upon U.S. securities laws. The rights of holders of our shares are governed by English law, including the Companies Act 1985, and by our memorandum and articles of association. The rights of holders of our ADSs are also affected by English law. These rights differ from the rights of security holders in typical U.S. corporations.

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

For the six months ended June 30, 2005 approximately 52% of our total revenues and 62% of our operating expenses were denominated in U.S. dollars. 40% of our revenues were in Euros, 5% of our revenues were denominated in British pounds sterling and 3% of our revenues were denominated in Swedish Krona. 28% of our expenses were in British pounds sterling and 10% of our expenses in Swedish Krona. Consequently we are exposed to fluctuations in Euro, British pounds sterling and Swedish Krona exchange rates. There can be no assurance that such fluctuations will not have a material effect on our results of operations in the future. We did not enter into any currency option hedge contracts in 2004 or the first six months of 2005.

**Item 4. Controls and Procedures**

We have evaluated the design and operation of our disclosure controls and procedures to determine whether they are effective. This evaluation was made under the supervision and with the participation of management, including our principal executive officer, and principal accounting and financial officer, within the 90-day period prior to the filing of this Quarterly Report on Form 10-Q. The principal executive officer, and principal accounting and financial officer, have concluded, based on their review, that our disclosure controls and procedures, as defined at Exchange Act Rules 13a-14(c) and 15d-14(c), are effective to ensure that information required to be disclosed by us in reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. No significant changes were made to our internal controls during our second quarter of 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

None

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults Upon Senior Securities**

None

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

(a) We held an Extraordinary General Meeting on May 24, 2005. Proxies for the meeting were solicited pursuant to Regulation 14A.

(b) The matter described below was voted on at the Extraordinary General Meeting, and the number of votes cast were as indicated:

1. To approve the issuance and sale by Insignia Solutions plc of up to \$12 million in American depositary shares representing ordinary shares, nominal value 20 pence (but not in excess of 20,000,000 shares, including 4,000,000 shares issuable on exercise of warrants), to Fusion Capital Fund II, LLC, an Illinois limited liability company, pursuant to a Securities Subscription Agreement dated February 10, 2005 between Insignia Solutions plc and Fusion Capital.

|            |         |         |
|------------|---------|---------|
| FOR        | AGAINST | ABSTAIN |
| 15,751,442 | 152,293 | 5,681   |

**Item 5. Other Information**

None

**Item 6. Exhibits**

The following exhibits are filed as part of this Report:

| <b>Exhibit<br/>Number</b> | <b>Exhibit Title</b>  |
|---------------------------|---|
| 31.1                      | Certificate of Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                  |
| 31.2                      | Certificate of Chief Financial Officer and Principal Accounting Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1                      | Certificate of Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                  |
| 32.2                      | Certificate of Chief Financial Officer and Principal Accounting Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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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.

**INSIGNIA SOLUTIONS PLC**

(Registrant)

Date: August 19, 2005

/s/ Mark E. McMillan  
MARK E. MCMILLAN  
Chief Executive Officer

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**EXHIBIT INDEX**

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