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PHOENIX TECHNOLOGIES LTD  
Form 10-Q  
August 03, 2001

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

(Mark ONE)

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

For the quarterly period ended JUNE 30, 2001

-----  
or

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

For the transition period \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 0-17111  
-----

PHOENIX TECHNOLOGIES LTD.  
(Exact name of Registrant as specified in its charter)

Delaware  
-----

04-2685985  
-----

(State or other jurisdiction  
of incorporation or organization)

(I.R.S. Employer Identification Number)

411 EAST PLUMERIA DRIVE, SAN JOSE, CALIFORNIA 95134  
(Address of principal executive offices, including zip code)

(408) 570-1000  
(Registrant's telephone number, including area code)

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

YES

NO

-----

-----

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, par value \$.001  
-----

25,202,609  
-----

Class

Number of Shares Outstanding at  
July 31, 2001

PHOENIX TECHNOLOGIES LTD.

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FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PHOENIX TECHNOLOGIES LTD.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(in thousands, except per share amounts)

	June 30, 2001	September 30, 2001
	-----	-----
	(unaudited)	
Assets		
Current Assets:		
Cash and cash equivalents	\$ 22,674	\$ 55,017
Short-term investments	44,289	52,701
Accounts receivable, net of allowances of \$1,488 at June 30, 2001 and \$2,283 at September 30, 2000	28,007	39,868
Deferred income taxes	7,926	3,926
Other current assets	8,112	4,494

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Total current assets	111,008	156,006
Investments	3,409	4,473
Property and equipment, net	12,182	13,272
Computer software costs, net	18,091	5,385
Goodwill and intangible assets, net	28,752	7,937
Deferred income tax	10,767	10,287
Other assets	2,000	1,400
	-----	-----
Total Assets	\$ 186,209	\$ 198,760
	=====	=====
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable	\$ 4,490	\$ 3,945
Accrued compensation and related liabilities	9,092	10,554
Deferred revenue	4,431	4,733
Income taxes payable	3,778	5,254
Other accrued liabilities	6,548	6,988
	-----	-----
Total current liabilities	28,339	31,474
Long-term obligations	563	1,449
Deferred income taxes	3,267	3,865
	-----	-----
Total Liabilities	32,169	36,788
	-----	-----
Minority Interest	17,304	13,672
	-----	-----
Stockholders' Equity:		
Preferred stock, \$.10 par value, 500 shares authorized, none issued	-	-
Common stock, \$.001 par value, 60,000 shares authorized, 25,141 and 25,608 shares issued and outstanding at June 30, 2001 and September 30, 2000	25	26
Additional paid-in capital	163,400	153,534
Retained earnings	53,316	53,890
Accumulated translation adjustment	(1,852)	(380)
Cost of treasury stock (4,753 and 3,377 shares at June 30, 2001 and September 30, 2000)	(78,153)	(58,770)
	-----	-----
Total stockholders' equity	136,736	148,300
	-----	-----
Total Liabilities and Stockholders' Equity	\$ 186,209	\$ 198,760
	=====	=====

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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PHOENIX TECHNOLOGIES LTD.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share amounts)  
(unaudited)

Three months ended June 30,

Nine months ended June 30,

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	2001	2000	2001
	-----	-----	-----
Revenues:			
License fees	\$ 27,129	\$ 31,696	\$ 82,4
Services	4,605	4,807	13,8
	-----	-----	-----
Total revenues	31,734	36,503	96,2
	-----	-----	-----
Cost of revenues:			
License fees	1,315	981	2,4
Services	3,982	4,900	11,3
Amortization of purchased technology	756	314	1,3
	-----	-----	-----
Total cost of revenues	6,053	6,195	15,2
	-----	-----	-----
Gross Margin	25,681	30,308	81,0
Operating expenses:			
Research and development	11,886	8,925	34,3
Sales and marketing	8,894	8,664	28,6
General and administrative	5,902	4,820	17,7
Amortization	1,689	555	3,3
Stock-based compensation	379	118	1,0
Restructuring cost	1,525	-	1,5
	-----	-----	-----
Total operating expenses	30,275	23,082	86,6
	-----	-----	-----
Income (loss) from operations	(4,594)	7,226	(5,5)
Interest and other income, net	1,204	1,395	2,5
Minority Interest	706	(10)	1,4
	-----	-----	-----
Income (loss) before income taxes	(2,684)	8,611	(1,53)
Income tax expense (benefit)	(996)	2,759	(96)
	-----	-----	-----
Net Income (loss)	\$ (1,688)	\$ 5,852	\$ (57)
	=====	=====	=====
Earnings (loss) per share:			
Basic	\$ (0.07)	\$ 0.23	\$ (0.0)
Diluted	\$ (0.07)	\$ 0.21	\$ (0.0)
Shares used in earnings (loss) per share calculation:			
Basic	25,098	25,871	25,1
Diluted	25,098	28,130	25,1

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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PHOENIX TECHNOLOGIES LTD.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(unaudited)

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	Nin
	-----
	20
	-----
Cash flows from operating activities:	
Net income (loss)	\$ (
Reconciliation to net cash provided by operating activities:	
Depreciation and amortization	9,
Stock-based compensation	1,
Minority interest	(1,
Deferred income tax	(1,
Change in operating assets and liabilities:	
Accounts receivable	11,
Other assets	(4,
Accounts payable	
Accrued compensation and related liabilities	(1,
Other accrued liabilities	(1,
Deferred Revenue	(
Income taxes payable	(5,
Net cash provided by (used in) operating activities	----- 6,
Cash flows from investing activities:	
Maturity of short-term and long-term investments	297,
Purchases of short-term and long-term investments	(288,
Purchases of property and equipment	(3,
Additions to computer software	(2,
Acquisition of businesses, net of cash acquired	(24,
Net cash provided by (used in) investing activities	----- (22,
Cash flows from financing activities:	
Proceeds from stock purchases under stock option and stock purchase plans	8,
Repurchase of common stock	(19,
Proceeds from issuance of stock	
Repurchase of warrant	(2,
Repayment of long term-obligations	(1,
Net cash provided by (used in) financing activities	----- (15,
Effect of exchange rate changes on cash and cash equivalents	(1,
Net increase in cash and cash equivalents	(32,
Cash and cash equivalents at beginning of period	55,
Cash and cash equivalents at end of period	----- \$ 22, =====

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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PHOENIX TECHNOLOGIES LTD.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(UNAUDITED)

## NOTE 1. DESCRIPTION OF BUSINESS

Phoenix Technologies Ltd. (together with its subsidiaries, "Phoenix" or the "Company") is a global leader in platformware system-enabling software solutions for PCs and connected digital devices. Its software provides compatibility, connectivity, security and manageability of the various components and technologies used in such devices. Phoenix provides these products primarily to platform and peripheral manufacturers (collectively, "OEMs") that range from large PC manufacturers to small system integrators. Phoenix also provides training, consulting, maintenance and engineering services to its customers. It markets and licenses its products and services primarily through a direct sales force, as well as through regional distributors and sales representatives. The Company has four business units (one of which, inSilicon Corporation ("inSilicon"), is a majority-owned subsidiary), each of which delivers leading products and professional services that enable connected computing.

## NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements as of June 30, 2001 and for the three and nine-months ended June 30, 2001 and 2000 have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). All intercompany accounts and transactions have been eliminated. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet as of September 30, 2000 was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended September 30, 2000.

In the opinion of the management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to summarize fairly the Company's financial position, results of operations and cash flows for the interim periods presented. The operating results for the three and nine-month periods ended June 30, 2001 are not necessarily indicative of the results that may be expected for the fiscal year ending September 30, 2001, or for any other future period.

### EARNINGS PER SHARE

Basic earnings per share is computed using the weighted-average number of common shares outstanding during each period. Diluted earnings per share is computed using the weighted-average number of common and dilutive common-equivalent shares outstanding during the period. Dilutive common-equivalent shares primarily consist of employee stock options, computed using the treasury stock method. The Company reported net losses for the three months and nine months ended June 30, 2001. The effects of outstanding options and warrants were not included in the calculation of diluted net loss per share, as their inclusion would be anti-dilutive.

### RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to the current year presentation.

PHOENIX TECHNOLOGIES LTD.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

## NEW ACCOUNTING PRONOUNCEMENTS

In the first quarter of fiscal year 2001, the Company adopted Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities", which establish accounting and reporting standards for derivative instruments and for hedging activities. The Company does not hold any derivative financial instrument and does not engage in hedging activities. Accordingly, the adoption of SFAS 133 does not have an impact on the Company's financial position, results of operations or cash flows.

## NOTE 3. PURCHASE COMBINATIONS

During the first nine months of fiscal 2001, the Company completed a number of business combinations, which were accounted for as purchases. The amounts allocated to goodwill and purchased intangible assets are being amortized on a straight-line basis. The estimated asset lives are determined based on projected future economic benefits and expected life cycles of the technologies. The amounts allocated to Purchased Technology are being amortized over periods of 3 to 6 years, the amounts allocated to Other Intangible Assets (comprised of customer lists and assembled work force costs) are being amortized over periods of 2 and 6 years, and the amounts allocated to Goodwill are being amortized over periods of 5 and 6 years.

The following is a summary of purchased transactions completed in fiscal 2001 (in millions):

Acquired company	Total purchase consideration	Total tangible assets	Purchased technology	Other intangible assets
By Phoenix:				
Integrity Sciences, Inc.	\$ 3.8	\$ -	\$ 3.4	\$ -
Ravisent Technologies, Inc.	\$ 17.8	\$ 0.4	\$ 8.1	\$ -
By inSilicon:				
Xentec, Inc.	\$ 11.8	\$ 0.3	\$ 0.2	\$ 0.5
HD Lab, K.K.	\$ 1.6	\$ -	\$ 1.3	\$ 0.3

The following are details of the form of consideration and their fair values for each acquisition:

Acquired company	Form of consideration

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Integrity Sciences, Inc.	\$2.5 million in cash	\$
	75,000 shares of Phoenix's common stock	\$
	Total	\$
-----		
Ravisent Technologies, Inc.	\$17.8 million in cash	\$
-----		
Xentec, Inc.	\$3.0 million in cash	\$
	15,678 and 618,378 shares of inSilicon common and preferred stock, respectively	\$
	Option to purchase 96,004 shares of inSilicon common stock	\$
	Transaction Costs	\$
	Total	\$
-----		
HD Lab, K.K.	\$1.6 million in cash	\$
-----		

The Integrity Sciences, Inc. acquisition also includes additional contingent consideration of up to 100,000 shares of the Company's common stock and cash payment of \$1.5 million, if certain revenue and technology criteria are met.

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PHOENIX TECHNOLOGIES LTD.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

The following unaudited, pro forma information shows the results of operations of the Company for the nine-month periods ended June 30, 2001 and 2000, as if the business combinations had occurred at the beginning of each period. This data is not indicative of the results of operations that would have arisen if the business combinations had occurred at the beginning of the respective periods. Moreover, this data is not intended to be indicative of future results of operations.

	Nine months ended June 30,	
	2001	2000
	-----	-----
Revenue	\$ 96,386	\$ 104,347
Net Income (Loss)	\$ (3,798)	\$ 8,521
Earnings (Loss) per share:		
Basic	\$ (0.15)	\$ 0.34
Diluted	\$ (0.15)	\$ 0.31

NOTE 4. EARNINGS (LOSS) PER SHARE

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The following table presents the calculations of basic and diluted earnings per share under Statement of Financial Accounting Standards No. 128 ("SFAS 128"), "Earnings per Share" (in thousands, except per share amounts):

	Three months ended June 30,		Nine months ended Jun	
	2001	2000	2001	2000
Net income (loss)	\$ (1,688)	\$ 5,852	\$ (574)	\$ 13,60
Weighted average common shares outstanding	25,098	25,871	25,162	24,97
Effect of dilutive securities (using the treasury stock method):				
Stock options	-	1,769	-	2,28
Warrants	-	490	-	50
Total dilutive securities	-	2,259	-	2,79
Weighted average diluted common and equivalent shares outstanding	25,098	28,130	25,162	27,77
Earnings (loss) per share:				
Basic	\$ (0.07)	\$ 0.23	\$ (0.02)	\$ 0.5
Diluted	\$ (0.07)	\$ 0.21	\$ (0.02)	\$ 0.4

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PHOENIX TECHNOLOGIES LTD.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

NOTE 5. COMPREHENSIVE INCOME (LOSS)

Following are the components of comprehensive income (loss) (in thousands):

	Three months ended June 30,		Nine months ended Jun	
	2001	2000	2001	2000
Net income (loss)	\$ (1,668)	\$ 5,852	\$ (574)	\$13,608
Change in accumulated foreign currency translation adjustments	(672)	(114)	(1,472)	555
Comprehensive income (loss)	\$ (2,340)	\$ 5,738	\$ (2,046)	\$14,163

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NOTE 6. SEGMENT REPORTING

Segment information is presented in accordance with Statement of Financial Accounting Standards No. 131 ("SFAS 131"), "Disclosures about Segments of an Enterprise and Related Information." This standard requires segmentation based upon the Company's internal organization and disclosure of revenue and operating income based upon internal accounting methods. The Company has four reportable segments: Platform Enabling, inSilicon, Information Appliance, and PhoenixNet-TM-.

PLATFORM ENABLING: Provides system-enabling software that is used in the design, deployment and ongoing operation of industry standard desktop, notebook and server PCs. The Platform Enabling's flagship software products provide support for current technologies and industry standards, allowing systems and device manufacturers to base new product designs on a range of microprocessors, chipsets and operating systems combinations.

INSILICON: Provides communications technology that is used by semiconductor and systems companies to design complex semiconductors called systems-on-a-chip that are critical components of digital devices. inSilicon provides cores, related silicon subsystems and firmware to customers that use its technologies in hundreds of different digital devices ranging from network routers to handheld computers.

INFORMATION APPLIANCE: Provides technology to electronics OEMs to develop information appliance designs. Information Appliance software delivers an easy-to-implement, low cost/high value architecture that enables "instant-on" Internet access and browsing capability for devices such as Internet TV, interactive screen phones, and handheld appliances. This newly created division was launched on March 27, 2001.

PHOENIXNET-TM-: Provides technology infrastructure that offers a high level of security for accessing corporate networks and the Internet through device authentication. Applications using this infrastructure for virtual private networks (VPNs) and the Internet are supported by a global network of Regional Device Authorities.

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PHOENIX TECHNOLOGIES LTD.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

The Company evaluates operating segment performance based on revenue and operating income as follows (in thousands):

	Three months ended June 30,		Nine months ended Jun	
	2001	2000	2001	2000
Revenues:				
Platform Enabling	\$ 22,505	\$ 29,445	\$ 75,761	\$ 85,7
inSilicon	5,041	6,528	15,384	17,2

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Information Appliance	3,263	-	3,263	
PhoenixNet	925	530	1,862	6
	-----	-----	-----	-----
Total	\$ 31,734	\$ 36,503	\$ 96,270	\$ 103,5
	=====	=====	=====	=====
Income (loss) from operations:				
Platform Enabling	\$ 2,296	\$ 9,466	\$ 14,126	\$ 26,6
inSilicon	(3,168)	(244)	(7,681)	(1,8
Information Appliance	(35)	-	(997)	
PhoenixNet	(3,687)	(1,996)	(11,000)	(7,5
	-----	-----	-----	-----
Total	\$ (4,594)	\$ 7,226	\$ (5,552)	\$ 17,2
	=====	=====	=====	=====

The Company also reports revenues by geographic area, which is categorized into five major countries/regions: North America, Japan, Taiwan, other Asian countries, and Europe (in thousands):

	Three months ended June 30,		Nine months ended Jun	
	2001	2000	2001	2000
	-----	-----	-----	-----
Revenues:				
North America	\$ 8,865	\$ 11,897	\$ 28,930	\$ 29,07
Japan	16,030	11,827	34,535	33,64
Taiwan	1,868	9,751	17,550	31,10
Other Asian Countries	2,641	928	8,042	2,56
Europe	2,330	2,100	7,213	7,20
	-----	-----	-----	-----
Total	\$ 31,734	\$ 36,503	\$ 96,270	\$103,59
	=====	=====	=====	=====

NOTE 7. STOCK REPURCHASE PROGRAM

During the quarter ended December 31, 2000, the Company repurchased 1,028,400 shares of its common stock at a cost of \$15.9 million, under a program that was authorized by the Board of Directors in fiscal 2000. As of December 31, 2000, the fiscal 2000 repurchase program was completed and terminated.

In February 2001, the Board of Directors authorized an additional program to repurchase up to \$30 million of outstanding shares of common stock over a 12-month period. During the quarter ended March 21, 2001, the Company repurchased from Intel Corporation an outstanding warrant to purchase 1,073,965 shares of Phoenix Technologies common stock for approximately \$2.9 million under the program. During the quarter ended June 30, 2001, the Company repurchased 347,700 shares of common stock at a cost of \$3.5 million.

NOTE 8. RESTRUCTURING CHARGES

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In April 2001, in efforts to optimize operation efficiency and change its business strategy to address changes in customer demands, the Company reduced its global workforce by approximately 10%. The restructuring included refocusing R&D efforts, re-evaluating S&M and G&A resource requirement, and adjusting overall cost structure given current revenue levels.

The restructuring effort resulted in a charge of approximately \$1.5 million for severance and related cost in the third quarter of fiscal 2001. As of June 30, 2001, expenses of \$1.3 million had been paid and approximately \$0.2 million was accrued and expected to be paid through the first quarter of fiscal 2002.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Report on Form 10-Q, including without limitation the Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21 (E) of the Securities Exchange Act 1934, as amended. These statements include, but are not limited to, statements concerning increases in research and development activities, future liquidity and financing requirements, expected price erosion, plans to make acquisitions, dispositions or strategic investments, expectation of increased sales to original equipment manufacturers, and plans to improve and enhance existing products and develop new products.

These forward-looking statements are subject to risks and uncertainties. Some of the factors that could cause future results to materially differ from the recent results or those projected in the forward-looking statements include, but are not limited to, significant increases or decreases in demand for our products, increased competition, lower prices and margins, failure to successfully develop and market new product and technologies, competitor introductions of superior products, continued industry consolidation, instability and currency fluctuations in international markets, product defects, failure to secure intellectual property rights, and failure to recruit and retain key employees. For a more detailed discussion of certain risks associated with our business, see the "Business Risks" section in our Annual Report on Form 10-K for the year ended September 30, 2000.

#### COMPANY OVERVIEW

We are a global leader in platformware system-enabling software solutions for PCs and connected digital devices. Our software provides compatibility, connectivity, security and manageability of the various components and technologies used in such devices. These products are primarily provided to platform and peripheral manufacturers (collectively, "OEMs") that range from large PC manufacturers to small system integrators. We also provide training, consulting, maintenance and engineering services to our customers. Our products and services are primarily marketed and licensed through a direct sales force, as well as through regional distributors and sales representatives. We have four business units (one of which, inSilicon Corporation ("inSilicon"), is a majority-owned subsidiary), each of which delivers leading products and

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professional services that enable connected computing.

Our operations include the following:

**PLATFORM ENABLING:** Provides system-enabling software that is used in the design, deployment and ongoing operation of industry standard desktop, notebook and server PCs. The Platform Enabling's flagship software products provide support for current technologies and industry standards, allowing systems and device manufacturers to base new product designs on a range of microprocessors, chipsets and operating systems combinations.

**INSILICON:** Provides communications technology that is used by semiconductor and systems companies to design complex semiconductors called systems-on-a-chip that are critical components of digital devices. inSilicon provides cores, related silicon subsystems and firmware to customers that use its technologies in hundreds of different digital devices ranging from network routers to handheld computers.

**INFORMATION APPLIANCE:** Provides technology to electronics OEMs to develop information appliance designs. Information Appliance software delivers an easy-to-implement, low cost/high value architecture that enables "instant-on" Internet access and browsing capability for devices such as Internet TV, interactive screen phones, and handheld appliances. This newly created division was launched on March 27, 2001.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

**PHOENIXNET-TM-:** Provides technology infrastructure that offers a high level of security for accessing corporate networks and the Internet through device authentication. Applications using this infrastructure for virtual private networks (VPNs) and the Internet are supported by a global network of Regional Device Authorities.

#### RESULTS OF OPERATIONS

##### REVENUES

Our products are generally designed into personal computer systems, information appliances and semiconductors. License fee and service revenues by segment for the three and nine-month periods ended June 30, 2001 and 2000 were as follows (dollars in thousands):

	Amount		
	2001	2000	% CHANGE
Three months ended June 30:			
Platform Enabling	\$ 22,505	\$ 29,445	-23.60%
inSilicon	5,041	6,528	-22.80%
Information Appliance	3,263	-	-
PhoenixNet	925	530	74.50%

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Total revenues	\$ 31,734	\$ 36,503	-13.10%
	=====	=====	
Nine months ended June 30:			
Platform Enabling	\$ 75,761	\$ 85,717	-11.60%
inSilicon	15,834	17,213	-10.60%
Information Appliance	3,263	-	-
PhoenixNet	1,862	669	178.30%
	-----	-----	
Total revenues	\$ 96,270	\$ 103,599	-7.10%
	=====	=====	

Total revenues in the third quarter and first nine months of fiscal 2001 decreased by 13.1% and 7.1%, respectively, from the comparable periods in fiscal 2000, primarily as a result of the global economic downturn and the continued softness in the PC industry.

Platform Enabling revenues in the third quarter and first nine months of fiscal 2001 decreased by 23.6% and 11.6%, respectively, from the comparable periods of fiscal 2000, mainly due to continued softness in the PC industry which had a significant negative impact on our core business in the Taiwan market.

inSilicon revenues, net of intercompany transactions, declined by 22.8% and 10.6% in the third quarter and in the first nine months of fiscal 2001, respectively, from the comparable periods in fiscal 2000, due to a decrease in demand in North America in the third quarter of fiscal 2001, resulting from increasingly cautious purchasing behavior of customers in the current economic environment.

Information Appliance first generated revenues in the third quarter of fiscal 2001. North America and Japan were the two main regions contributing to these revenues.

PhoenixNet revenues increased by 74.5% and 178.3% in the third quarter and the first nine months of fiscal 2001, primarily due to a shift in business focus from homepage and search settings solutions to device authentication security products and services. During the quarter ended June 30, 2001, PhoenixNet completed significant agreements with regional device authority industry leaders. Comparison of PhoenixNet revenues for the first nine months of fiscal 2001 to the comparable period in fiscal 2000 is not applicable, as PhoenixNet first generated revenues in the second quarter of fiscal 2000.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Revenues by geographic region for the three and nine months ended June 30, 2001 and 2000, were as follows (dollars in thousands):

Amount

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	2001	2000	% CHANGE
Three months ended June 30:			
North America	\$ 8,865	\$ 11,897	-25.50%
Japan	16,030	11,827	35.50%
Taiwan	1,868	9,751	-80.80%
Other Asian Countries	2,641	928	184.60%
Europe	2,330	2,100	11.00%
<b>Total revenues</b>	<b>\$ 31,734</b>	<b>\$ 36,503</b>	<b>-13.10%</b>
Nine months ended June 30:			
North America	\$ 28,930	\$ 29,071	-0.50%
Japan	34,535	33,647	2.60%
Taiwan	17,550	31,105	-43.60%
Other Asian Countries	8,042	2,567	213.30%
Europe	7,213	7,209	0%
<b>Total revenues</b>	<b>\$ 96,270</b>	<b>\$ 103,599</b>	<b>-7.10%</b>

Revenues from Taiwan declined by 80.8% and 43.6% in the third quarter and the first nine months of fiscal 2001, respectively, from the comparable periods in fiscal 2000. The global economic downturn and the continued softness in the PC industry resulted in a decline in demand for system enabling software particularly in our Taiwan market. Revenues from other Asian countries increased due to expanded sales in the PhoenixNet security products and Information Appliance software solutions.

Two customers accounted for 19% and 12%, respectively, of total revenues for the three-month period ended June 30, 2001, whereas one of these customers accounted for 15% of total revenues during the nine-month period of fiscal 2001. For the three and nine-month periods ended June 30, 2000, the same customer accounted for 13% of total revenues in both periods.

#### GROSS MARGIN

Gross margin as a percentage of revenues for the three-month period ended June 30, 2001, decreased to 80.9% from 83.0% from the comparable period in fiscal 2000 due to lower margin on Information Appliance and inSilicon product sales. Gross margin as a percentage of revenues for the nine-month period ended June 30, 2001 increased to 84.2% from 83.3%, from the comparable period in fiscal 2000 due to a shift to higher margin services.

#### RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses for the three and nine-month periods ended June 30, 2001 increased by \$3.0 million and \$5.0 million, respectively, from the comparable periods in fiscal 2000. The increase between the periods reflected expenses related to recent acquisitions, investment in the newly formed Information Appliance division, on-going incremental development efforts associated with our

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

system enabling software, and establishment of development centers in Asia. As a percentage of revenues, research and development expenses in the three and nine-month periods ended June 30, 2001 increased to 37.5% and 35.7% from 24.5% and 28.1%, respectively, for the comparable periods of fiscal 2000, primarily due to higher expenses as noted above and a decline in revenues.

#### SALES AND MARKETING EXPENSES

Sales and marketing expenses for the three and nine-month periods ended June 30, 2001 increased by \$0.2 million and \$5.4 million, respectively, from the comparable periods in fiscal 2000. As a percentage of revenues, sales and marketing expenses in the three and nine-month periods ended June 30, 2001 increased to 28.0% and 29.8% from 23.7% and 22.5%, respectively, for the comparable periods of fiscal 2000. The increase was due primarily to the increase in the size of our direct sales force and the expansion of our distribution channels to position ourselves for growth in the security and Information Appliance markets. Management has made a conscious effort to increase sales and marketing efforts through the reallocation of resources.

#### GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses for the three and nine-month periods ended June 30, 2001 increased by \$1.1 million and \$3.3 million, respectively, from the comparable periods in fiscal 2000. The increases are mainly attributable to investment in infrastructure, higher inSilicon expenses related to an increase in the bad debt provision and addition of new personnel. As a percentage of revenues, general and administrative expenses in the three and nine-month periods ended June 30, 2001 increased to 18.6% and 18.4%, respectively, from the 13.2% and 13.9% for in the comparable periods of fiscal 2000, primarily due to the decline in total revenues and higher expenses as noted above.

#### AMORTIZATION EXPENSES

Amortization of goodwill and acquired intangible assets included in operating expense was \$1.7 million and \$3.4 million for the three and nine-month periods ended June 30, 2001, respectively, as compared to \$0.6 million and \$1.7 million from the comparable periods in fiscal 2000. Amortization of goodwill and acquired intangible assets relates primarily to various acquisitions (see Note 3 to Condensed Financial Statements).

#### STOCK-BASED COMPENSATION

The stock-based compensation charges in both the three and nine-month periods ended during fiscal years 2001 and 2000 were primarily due to the granting of options to purchase inSilicon stock at exercise prices less than the fair market value of inSilicon common stock on the grant date.

#### RESTRUCTURING CHARGES

In April 2001, in efforts to optimize operation efficiency and change its business strategy to address changes in customer demands, the Company reduced its global workforce by approximately 10%. The restructuring included refocusing R&D efforts, re-evaluating S&M and G&A resource requirement, and adjusting overall cost structure given current revenue levels.

The restructuring effort resulted in a charge of approximately

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\$1.5 million for severance and related cost in the third quarter of fiscal 2001. As of June 30, 2001, expenses of \$1.3 million had been

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

paid and approximately \$0.2 million was accrued and expected to be paid by the first quarter of fiscal 2002.

#### INTEREST AND OTHER INCOME, NET

Interest and other income, net, for the three and nine-month periods ended June 30, 2001, decreased 13.7% and 7.3%, respectively, from the comparable periods in fiscal 2000, primarily due to a decrease in cash balance from funding stock repurchase program and making additional acquisitions.

#### PROVISION FOR INCOME TAXES

Our effective tax rates, excluding minority interest, for the three months and nine months ended June 30, 2001, were 29% and 32%, respectively, compared to 32.0% for the comparable periods of fiscal 2000. For federal income tax purposes, we do not file a consolidated return with inSilicon as we own less than 80% of inSilicon's issued outstanding voting stock.

#### LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2001, our principal source of liquidity consisted of cash and cash equivalents, and short-term investments totaling \$67.0 million, of which \$31.6 million was owned and restricted for the use of inSilicon. The primary sources of cash during the first nine months of fiscal 2001 were \$6.9 million from operating activities, net sales of short-term investments of \$9.0 million and proceeds from issuance of stock under various stock plans of \$8.0 million. The primary uses of cash during the first nine months of fiscal 2001 were \$24.8 million to fund certain acquisitions (see Note 3 to Condensed Financial Statements), \$22.3 million for the repurchase of common stock and warrants, and \$6.5 million for the purchase of property, equipment and computer software.

We believe that current cash, short-term investment balances and cash flow from operations will be sufficient to meet our operating and capital requirements on a short-term and long-term basis.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For financial market risks related to changes in interest rate, foreign currency exchange rates, and investment, refer to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in the Company's Annual Report on Form 10-K for the year ended September 30, 2000.

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PART II. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) None

(b) The Company filed no reports on Form 8-K during the three months ended June 30, 2001.

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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.

PHOENIX TECHNOLOGIES LTD.

Date: August 3, 2001  
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By: /s/ JOHN M. GREELEY  
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John M. Greeley  
Senior Vice President and Chief Financial Officer

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