

Transcript of Socket Mobile, Inc. (SCKT) Third Quarter 2011 Management Conference Call October 25, 2011

Vcall
601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com

Participants

Kevin J. Mills, President and Chief Executive Officer
David W. Dunlap, Chief Financial Officer
Jim Byers, Investor Relations, MKR Group, Inc.

Presentation

Operator

Greetings and welcome to the Socket Mobile Third Quarter 2011 Management Conference Call. At this time, all participants are on a listen-only mode. A brief question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press *0 on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Jim Byers with the MKR Group.

Jim Byers – MKR Group, Inc. – Investor Relations

Thank you, operator.

Good afternoon and welcome to Socket's conference call to review financial results for its 2011 third quarter. On the call today from Socket Mobile are Kevin Mills, President and CEO; and Dave Dunlap, CFO.

Socket Mobile distributed its earnings release over the wire service at the close of the market today. The release has also been posted on Socket's website at www.socketmobile.com. In addition, a replay of today's call will be available at www.vcall.com shortly after the call's completion and a transcript of this call will be posted on the Socket's website within a few days. We've also posted replay numbers in today's press release for those wishing to replay this call by phone. The phone replays will be available for one week.

Before we begin, I would like to remind everyone that this conference call may contain forward-looking statements within the meaning of Section 27-A of the Securities Act of 1933 as amended and Section 21-E of the Securities and Exchange Act of 1934 as amended. Such forward-looking statements include, but are not limited to, statements regarding mobile computer, data collection and OEM products including details on timing, distribution, and market acceptance of products, and statements predicting trends of sales and market conditions and opportunities in the markets in which Socket sells its products.



Such statements involve risks and uncertainties and actual results could differ materially from the results anticipated in such forward-looking statements as a result of a number of factors including, but not limited to, the risk that manufacture of Socket's products may be delayed or not rolled out as projected due to technological, market, or financial factors including the availability of product components and necessary working capital; the risk that market acceptance and sales opportunities may not happen as anticipated; the risk that Socket's application partners and current distribution channels may choose not to distribute the products or may not be successful in doing so; the risks that acceptance of the company's products and vertical application markets may not happen as anticipated; and other risks described in Socket's most recent Form 10-K and 10-Q reports with the Securities and Exchange Commission. Socket does not undertake any obligation to update any such forward-looking statements.

Now with that said, I would like to turn the call over to Socket's President and CEO, Kevin Mills.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Thanks, Jim, and thank you for joining us today.

In today's call, we will begin with a short review of Q3 and then outline the business opportunities we see for the rest of this year.

We are pleased to report for Q3 our second consecutive quarter of positive EBITDA and continued sequential growth in revenue. Our increase in positive EBITDA was achieved through a combination of increased revenue, increased margins, and continued tight management of expenses. Remaining EBITDA positive is clearly important to achieving our goal of profitability, which we hope to reach in Q4.

I'll begin with a review of our current handheld computing business and then provide a going forward outlook. Our handheld computing related sales, which include our handheld computers and plug-in barcode scanners, grew to \$2.8 million for the third quarter, a 9% sequential increase over the preceding quarter. While this is a solid increase, sales in the third quarter were still constricted by limited supply, an issue we have mentioned before.

I am pleased to note that the LCD supply issues were resolved in Q3 but, unfortunately, it was a few weeks later in the quarter than originally anticipated. The result of these few weeks is that over 1,000 SoMos, which were shipped in Q3, did not get recognized as revenue in the quarter as there was not enough time to clear the distribution channels before the quarter ended. The positive news is that our many customers did receive their units in early Q4, which is very important to the health of both our businesses. We believe the LCD supply problems are behind us and we will continue to catch up during Q4.

On the demand side, we are continuing to see good demand driven by several factors. Currently, the impact of HP's exit from the classic PDA market is now clearly a positive influence in driving demand. We have many customers, or potential customers, looking to replace their HP iPAQ with Socket's SoMo handheld. The full

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com



impact of this effect is still difficult to determine given our own supply issues. But we have many customers that have received sample SoMos that they are evaluating as the ideal replacement.

We have already established the SoMo as the default replacement in some markets such as Japan, where HP exited late last year. In other markets, including in the US, we are still in an evaluation phase and are focused on demonstrating to customers that the SoMo is fully compatible with, and in many ways better than, the iPAQ and that Socket is a credible supplier. As mentioned, we have significantly improved product availability in Q3 and expect further improvements in Q4.

So to summarize on our SoMo, demand remains strong and supply has substantially improved in late Q3, early Q4. Customers and potential customers are substantially happier with the SoMo and Socket. We expect to further improve our delivery performance in Q4 and to enter 2012 with a manageable backlog.

Turning to our cordless scanning business. Sales in the third quarter of our cordless barcode scanning products, which includes sales of both our cordless hand scanners and cordless ring scanners, were up by 25% over the preceding quarter, primarily driven by the positive effect of Apple certification on our cordless hand scanning sales.

Our cordless hand scanner business continues to be driven by companies that collect data using a combination of mobile phones and tablets while reading barcodes. The cordless hand scanner portion of our cordless scanning business was up by 50% sequentially and will remain the primary driver of our cordless scanning business going forward.

In this mobile phone centric market, we are serving customers who require commercial grade barcode scanning capabilities. Users are generally running business critical functions with the software applications running on the mobile device. As we noted in our last call, we are seeing very strong interest from both Apple and Android customers representing many different market segments, with medical and pharma related representatives being the first group to begin rollups.

In early Q3, we introduced and began shipping our Apple software developers kit or SDK for SocketScan 10. We then announced that Apple had approved our 7Xi scanner, which allowed us to label the units as iPhone, iTouch and iPad certified, and assure developers that they would be able to fully manage the scanner and associated data from their Apple application. The 7Xi and the 7XiRx scanners both contain extra components that make this certification possible.

We also announced both our first SDK development and 7Xi customer win with Cook Medical. Cook Medical has an application that is centered in the pharma market with over 500 medical representatives using the solution to audit over 1,000 hospitals on a daily basis. This is just one of the many applications we are seeing in the markets and we expect to generate continued traction going forward. In our previous call, we noted that we are seeing many developers beginning to use our software

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com



development kits and incorporate robust scanning into their applications, a very exciting trend that we see continuing.

Finally, within the cordless hand scanning category, we announced the 7C scanner. We expect this scanner to be the one to help us break into the sub-\$200 category for a robust and dependable cordless scanner. The 7C is about 25% less in price than our current 7E scanner, with slightly better performance. We believe the 7C is an exciting product at a very attractive price point that we expect will be a volume product for Socket next year.

We expect continued growth in our cordless scanning business going forward with sales of our cordless scanning expected to be up sequentially in both Q4 and Q1 as we continue to build momentum as more and more apps are developed and deployed.

We are excited about the growth in both our handheld and cordless scanning businesses, which combined represented 88% of our total Q3 revenue. Going forward, we believe the growth of these two businesses will drive the growth of the company. The remaining 12% of our revenue is made up of service, legacy products, and OEM.

There are two additional very important achievements that I will also like to mention. We converted our \$1 million notes into common stock in Q3, which made it possible to reestablish our bank line with Silicon Valley Bank in early Q4. I believe these two accomplishments are critical to our future success as they enable us to fund our growth going forward. Dave will talk about these items in greater detail in a few minutes, but let me say that I believe we are a substantially stronger company now that we've eliminated our debts and restored our credit line.

In summary, Q3 was very positive on a number of fronts that included increased sales in key areas, increased EBITDA, and improved supply. In addition, we substantially improved our balance sheet, increasing the confidence of both suppliers and customers and making it substantially easier to grow the business going forward.

I would now like to turn the call over to Dave for his comments.

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

Thank you, Kevin.

Our third quarter 2011 revenue was \$4.7 million, a 37% increase over third quarter revenue a year ago and an 8% increase over second quarter's revenue of \$4.4 million.

We're pleased to report our second consecutive quarter of positive earnings before interest, taxes, depreciation, and amortization or EBITDA, which totaled \$142,000 or \$0.03 per share for the third quarter, up from \$73,000 or \$0.02 per share in the second quarter. And although our revenues in the third quarter only grew by \$323,000 or 8% over the previous quarter, we shipped an additional \$800,000 of product that did not clear the distribution channel by the end of the quarter, an increased shipping pace of 25% quarter-over-quarter. We defer revenue recognition

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com



until our products clear distribution and many of our products shipped too late in the quarter to clear the channel by quarter end and will qualify as revenue in the fourth quarter.

We resolved our LCD screen shortage in the latter part of August and our contract manufacturer has been steadily manufacturing our SoMo 650 handheld computers since that time. We entered the quarter with an order backlog of \$3.4 million and exited the quarter with an order backlog of nearly \$3 million. We expect to significantly reduce that backlog as our shipments continue to catch up with customer demand during the fourth quarter.

New orders received during the third quarter were \$5.7 million, up from \$5 million in the second quarter. As Kevin mentioned, the pace of handheld computer orders continues to benefit from Hewlett-Packard discontinuing its classic PDA model 200 series. Our handheld computer, the SoMo 650, is a logical replacement, running the same Windows Mobile operating system in a similar size computer and designed for use by mobile workers while mobile.

Our barcode scanner orders are also benefitting from our Apple certified barcode scanners, certified during the third quarter by Apple for use with Apple products to scan both linear and 2D barcodes. More than 100 software developer kits have been acquired by developers looking to add our sophisticated barcode scanning software to applications running on a wide range of devices, including handheld computers, smartphones, and tablets running a variety of operating systems including Apple, Android from Google, BlackBerry from Research In Motion, and Windows and Windows Mobile from Microsoft.

Our most recent announcement of a new low-cost barcode scanner priced in the low \$200 range that will ship by the end of this year should further expand our barcode scanner sales at the entry level.

In both the second and third quarters of 2011, our SoMo-related revenues, which include our plug-in barcode scanners used primarily with our handheld computers, approximated 60% of our revenue. Cordless scanning revenues grew at a more rapid pace, increasing from 23% of our revenue in the second quarter to 27% of our revenue in Q3. Thus our primary products, both of which are growing, now represent nearly 88% of our revenues, with the balance being OEM, legacy, and service. We expect those trends to continue in the fourth quarter.

Momentum in our sales pipeline is being generated by demand for the Apple cordless barcode scanners and momentum in our handheld computer sales pipeline is being generated by both new applications and by Hewlett-Packard's departure from the classic PDA market. With both of our major product lines growing, we are enjoying watching the race between them to grow the fastest and to become the largest product line. Approximately, one-third of our revenue in the third quarter came from international customers. Asia-Pacific was our fastest growing international region in the third quarter where the SoMo handheld computer is becoming well established as a replacement for the HP 200 series handheld computer, particularly in Japan.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com



I also want to mention our SocketCare service program. We encourage our customers to purchase extended warranty and accidental breakage coverage at the time they purchase our handheld computers and barcode scanners. One of Socket's hallmarks is providing its customers with timely and responsive customer service, and we announced during the third quarter an expansion to that program to include additional products and to provide more options including the ability to further extend SocketCare coverage beyond its initial three-year term. The program is a good source of revenue for the company, assists companies in covering repair and maintenance by purchasing SocketCare, and reflects our confidence in both the quality and the durability of our products.

Our third quarter was a positive momentum quarter for the company in many other respects. In addition to increased demand for our products and increased shipments, with growth we continued to improve our dollar margin contribution, up 47% from the third quarter a year ago and up 9% from the immediately preceding quarter.

Our third quarter operating expenses were flat with the third quarter a year ago and up just 5% from the immediately preceding quarter, allowing much of the improving contribution margin to pass through to the bottom line. Our bottom line included a number of non-EBITDA, non-cash charges, the largest being a charge for unamortized debt discount of \$564,000 or \$0.13 per share and stock option expense of \$189,000 or \$0.04 per share. The unamortized debt discount was associated with the convertible note issued in November 2010. We were successful by calling the notes and, with the cooperation of the note holder, in converting all of the remaining notes into common stock during the third quarter and thus removing its overhang from our balance sheet. And with the notes fully converted, we were able to announce in October the reinstatement of a revolving bank line of credit of \$2.5 million that we will use as a working capital line to help fund our growth, particularly in assuring our vendors of timely payments for our products.

For the past two years, Socket has operated as a significantly leaner organization including fewer employees and extensive cost reduction programs that reduced salaries and discretionary spending. At the same time, we've retained key employees and funded the essential development programs that are benefitting us today and will benefit us in the future.

We remain firmly committed to serving the business mobility markets with our mobile handheld computers and data collection products. We support Windows Mobile applications on our SoMo 650 handheld computer. Our linear and 2D barcode scanners and our RFID readers with our sophisticated but easy to incorporate SocketScan software are compatible with Windows Mobile, Windows, BlackBerry, Android, and Apple operating systems running on a wide range of smartphones, tablets, notebooks, and other mobile computing devices.

Socket continues to be highly leveraged both on the supply side with its contract manufacturers, we have plenty of capacity to support growth, and on the distribution side with our many distribution partners and application partners that are interacting with customers around the world. Our goal remains to continue to grow our revenue and bring growing sustained profitability to the bottom line.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com



Now, let me turn the call back to the operator for your questions. Operator?

Operator

Thank you. We'll now be conducting a question and answer session. . If you would like to ask a question, please press *1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press *2 if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the * key. One moment please while we pool for questions.

Our first question comes from the line of Brian Swift with Security Research Associates. Please go ahead.

Brian Swift – Security Research Associates

Thank you. A couple of things. Can you elaborate a little bit on how are you progressing in terms of your sell through distribution and how are you contacting some of the Hewlett-Packard customers that you are going to try to have them make the transition from the HP product line into the SoMo?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Okay. We've done a number of things. One is that we have acquired a number of AdWords so people who are searching on Google or other search engines are able to find the SoMo even if they start out in their search looking for HP. And that alone has increased our traffic by about 5% to our sites, where people actually start out looking for an HP device, whether it would be the device or the battery, and end up coming to our site and finding the alternative.

We've also worked with our distributor partners. Today, we haven't worked as aggressively in all countries as we need to because we didn't have the supply. But it's our intention as we enter Q4 and we fix our supply problems that we would reach out to the many customers who did buy from distribution. We have access to those lists and now that we're not impinging or infringing on any HP business, our distribution partners are happy to work with us to make sure customers will find the device that will work for them and their application.

In certain countries, Japan is a best example, obviously, we have done more because we had supply and we had good relationships. I think the last, which is not insignificant, is that HP salespeople have been quietly recommending the SoMo to a number of their customers, and many of the calls that come in to Socket now, when we ask the question how did they hear about the SoMo, the response is that they were advised by HP representatives to contact Socket.

So I would say there's still more activity to be done to get HP customers across to Socket and we'll pick up the pace of that in Q4 now that we're better able to service the business.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com

Brian Swift – Security Research Associates

And can you just add, what are the alternatives for these HP customers besides switching over to Socket? Last man standing?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

You're never the last man standing and people always have choices. But I think that most people are married to their software. And they have a big investment in their software application. And if they have made a software application on a Windows Mobile platform, there are limited supply choices available going forward.

Certainly Motorola, Intermec and Psion Teklogix still make and sell many Windows Mobile centric devices, as do we, and as did HP. I think that the difficulty many people have is the price points. HP had a very attractive price point at around \$400 and we have a very attractive price point at around \$500, maybe \$520, and we are certainly closest to what HP had in the markets. And we believe we have enough benefits and features to cover this additional \$100 in expense. Most of the ruggedized devices whether it be from Motorola or Intermec or Psion Teklogix start above \$1,000 and people simply don't have the money.

And so the first choice is do you want to stick with Windows Mobile? And a lot of people do because getting mobile applications up and going is quite difficult and once you have it up and going, you're not anxious to change it. Your alternative then is that you decide to rewrite your application into the Apple world or into the Google world, et cetera and with all these, there are trade-offs. In many of the applications, for example, you need to change the battery during the shift or during the work. And if you need to change the battery that eliminates all the Apple devices since you're not allowed to change the battery.

On the Google Android devices, I would say there is still a lot of development work being done and the rates at which the operating system is being upgraded, and it's quite scary for people who want to deploy. So we've seen in the last year Android go from probably 1.5 to three point something and in that there has been at least, I would say, 10 iterations. The difficulty you have is when you're deploying mobile solutions into a non-homogenous environment then your tech support and usability issues go through the roof.

So there are other choices. I think that we are the easy option for people coming from the HP world and I think we're the easy option for people who are looking for a very stable platform, which I think Windows Mobile has established. Certainly, if people have more money, they can go up into more ruggedized devices but the price delta is significant. So we feel we're in a pretty solid position for the moment and we have to continue to work at it to basically endear ourselves to these customers and ensure that they understand we're both committed to this space long term as well as we're a credible and reliable supplier. And I think we're doing the right things now to make this happen. I would have to admit that, over the last six months, we haven't been the best supplier due to our supply problems but, as we said, we believe this is now behind us.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



Brian Swift – Security Research Associates

Okay. One more. Maybe you can help set our expectations as far as the December quarter. If we look at September and based on with you shipped, maybe not recognized, but if you were able to recognize, you would have been around \$5.5 million. So I guess for a going forward standpoint, I assume that those products that were shipped are now recognized and then from the standpoint that you want to reduce your backlogs, I guess one would kind of drive us to thinking that your fourth quarter should be something in the \$6 million area?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

I think our primary objective in Q4 is to get profitable. We have to fill up our distribution channels. We are continuing to ship well in October and we expect November to be equally strong. I would be pleased with a profitable Q4 and certainly based on where we started the year, I think a lot will have been achieved if we exit 2011 profitable with our bank lines in place and no debts and I think that would be a very good result for the year and I think that's within our graph right now.

Brian Swift – Security Research Associates

All right. And something a little over \$5 million is your breakeven level?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Yes, something over \$5 million is our breakeven level, probably something in the region of about \$5.5 million. I think that's well within our scope in Q4. So it would be a very good year for Socket to go from where we started at the beginning of 2011 to exit the year profitable and with the ability to grow the business rapidly now that we have bank lines in place.

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

Interesting, Brian, is that our third quarter was a loss of \$0.16 a share, but \$0.13 of that was debt discount amortization, which now that the notes are converted goes away. So we were at essentially \$0.03 a share loss. So our ability to move it up to profitability is there. Typically our third quarter is one of our least expensive quarters. We start to incur more audit related costs when we get into the fourth quarter. Our development programs vary quarter to quarter. So there are always some fluctuations, but certainly \$5.5 million is probably a good target for breakeven and, of course, we'd like to beat that.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com

Brian Swift – Security Research Associates

It seems like your expenses would have to go up quite a bit to push the breakeven to \$5.5 million. Are you going to bring back some more people now that you're...

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Yes, but not aggressively. I mean I think we will continue to manage expenses very tightly. We are spending a little more in R&D. It has been our trend for the last year. If you look at our expenses for the last nine months versus nine months of a year ago, we have reduced our expenses by over \$550,000 in sales and marketing and put some of that expense into R&D. I think that we are comfortable now that we have the structure in place to be very efficient in the sales and marketing area and we need to just finish a few projects in the R&D areas so that we have new products like the 7C continuing to come out in 2012.

Brian Swift – Security Research Associates

Okay. I'll let somebody else ask some questions and I will come back if I think of something else.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Okay. Thank you very much, Brian.

Operator

Thank you. Our next question is from Laura Engel with Stonegate Securities. Please go ahead.

Laura Engel – Stonegate Securities Inc.

Hi. Good afternoon. Thanks for taking my questions.

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

Hello, Laura.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Good afternoon, Laura.

Laura Engel – Stonegate Securities Inc.

Hello. You mentioned overall increasing gross margins, did you give a gross margin number that I missed, or can you give us a ballpark figure on the margin?

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

The gross margin in the third quarter was 42.7%, up from 42% even in the second quarter. The things that affect gross margin in the quarters are both product mix as well as volume because we have a large fixed component to our cost of service and sales revenue area representing the people who are processing and moving inventory and that group is fairly steady, but as volumes go up, you can spread those cost over a much larger base. So our third quarter margin was about 42.7% and with growth, we generally tend to improve that.

On the other hand, some of our fastest growth right now is in some of the newer product areas, and typically our newer products have a slightly lower gross margin

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com

and then as we cost reduce them, they come back up to more of our norms. So it's always a balancing act, but we've been fairly consistent over the last couple of quarters in the low-to-mid 40% range.

Laura Engel – Stonegate Securities Inc.

Okay. And then we turn back to the topic of operating expenses, you mentioned they were flat, was there any variation quarter over quarter between the categories or were they generally in line with the previous quarter?

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

We're talking third quarter compared to the previous quarter. Research and development was up about \$50,000; sales and marketing was up about \$60,000 to \$70,000. We did add some additional people in sales to help respond to the increasing call volume and interest that we are seeing from former HP and other customers. And then in our R&D area, again, some of the projects that we have going called for some additional expenditures in Q4. General and administrative costs were down. The things that drive G&A expenses tend to be things like the audit, which starts to pick back up in the fourth quarter. So overall, operating costs in the second quarter were \$2,038,000; and were \$2,139,000 in the third quarter.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

So about \$100,000.

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

About \$100,000.

Laura Engel – Stonegate Securities Inc.

All right. Okay. And then as far as the top line, how do you analyze it internally such as the areas that were driving growth by industry or by purchases by additional HP customers? Are there broader ways to look at that and what's driving that other than just additional units?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

We are continuing to see a lot of interest on the handheld side both from the healthcare and the hospitality markets. And in healthcare, it's a number of apps including things like lab work, taking orders from patients for their meals in hospitals, and various types of medication dispensing as well as long-term care. And I think that, you know, if I look at Japan is a good example, the main driver is long-term healthcare where HP had a pretty large installed base and we are picking up both the replenishment of units that are failing or being dropped or destroyed coupled with new deployments. We are seeing similar situations in Australia. A lot it is what I would describe as long-term healthcare or clinical work.

On the cordless scanning side, it's a huge mix and we already have a lot of industries looking to use the iPhones and Android phones or tablets to improve efficiency. And I think what stands out is that the pharmaceutical companies whether they be Cook Medical, Smith & Nephew, Johnson & Johnson, Abbott Labs, they seem to be the leaders in having solutions ready for their salespeople whether using an iPhone or

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



Android phone coupled with our scanners to monitor assets, that the sell by date on their pharmaceuticals hasn't been violated, and no recalls, et cetera.

So we have a lot of salespeople who are adding an auditing/inventory asset management function to their job in conjunction with mobile phones. We are seeing a lot of outside salespeople who are using the scanning stuff, whereas most of the handheld stuff is in-building.

I don't know if that gives you a better flavor and we can certainly go through in great detail now that we have reasonable numbers out there from our registration databases et cetera, we can see what people are doing with these devices and that certainly helps us to plot our strategy going forward to better serve the markets we're already doing well.

Laura Engel – Stonegate Securities Inc.

Okay. And just one last question on the SocketCare program, what are the expectations for increasing those revenues? Is the way you analyze it to look at the offering that's going to be driving the unit sales that basically the program covers. So what's the outlook for that program and extending that offering to your customers?

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

We're expecting to see our service revenues grow as an overall percentage of our total revenue. Today, our total revenues that we're recognizing are somewhere in the 4% to 5% of revenue range but we have not been shipping the quantities of SoMos, particularly the handheld computers that are excellent candidates for that type of extended warranty coverage, and so as we start to improve the shipments, the volumes, you get a natural increase in the amount of SocketCare services that are being purchased at the same time.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

And just maybe to add, if you look at other customers, Motorola or Intermec, they'll have between 20% and 30% of their revenue come from services. And I think, as Dave mentioned, we're probably in the 5% range right now and also people generally purchase these contracts as part of the deployment. And as we see deployments pick up, we've optimized the program to better suit what we feel the market is asking for. So the announcement of this new program makes us a little more competitive, has a little more coverage, and we feel we'll be able to move that percentage from the 5% range up hopefully into the 10% to 15% range, which would be more like what other people who deploy handhelds are getting.

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

And we have two categories of coverage. The SocketCare program itself, we will amortize the revenue over the life of the warranty coverage, so typically that's three years, but we also provide repairs and upgrades for out of warranty products and customers pay for those as they go, and that tends to also be a major part of our service revenue category.

The announcement, I think you saw earlier this quarter, reflected some nice improvements in our SocketCare program to cover more products, to extend the

Vcall
601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com



coverage with more variations for customers to tailor to their own needs, and the ability to extend the program beyond the initial three years.

So we've always focused on providing good customer care and customer support for our products and we find with quality products and with the durability of the products, these extended warranty programs work well for both us and for the customer who's able to build the coverage into their initial budgeting and planning cycle and not have to worry about ongoing costs as they go through the cycle of those products.

Laura Engel – Stonegate Securities Inc.

Okay. Thank you for taking my questions today. I appreciate it and, again, I can't wait for the fourth quarter. Thanks so much.

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

Thanks, Laura.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Thanks.

Operator

Thank you. Our next question is from Richard Siracusa with Merrill Lynch. Please go ahead.

Richard Siracusa – Bank of America Merrill Lynch

Congratulations on what appears to be the turning quarter. Kevin, you had mentioned that you would be entering 2012 with I think you refer to it as a manageable backlog?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Yes.

Richard Siragusa – Bank of America Merrill Lynch

And I wasn't sure if that was hoping it would be manageable or confident it would be manageable?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

It's confident that it would be manageable. I think one of the painful lessons that we learned in this whole supply issue is that, in some ways, we were shipping very aggressively against orders, which resulted in our distribution channel, particularly overseas, having very little inventory. And then when we went into a shortage situation, as can happen occasionally, there was no buffer in the channel. Whereas when I look at the US, they generally carry four weeks of inventory and, therefore, you have a little bit of time to recover. Our going forward strategy is to basically operate to a four week timeframe and to be consistent to that lead time where people can absolutely count on getting their products in the four weeks and to have our distribution partners carry a little more inventory.

Today, I don't think we're at that point. Certainly for the first nine months of the year, our lead times have probably been closer to twelve weeks than they have been to four

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com

weeks. I think right now, we're probably between eight and six weeks and we will get to four weeks before the end of the year.

What I want to make sure is people understand that we're going to try and keep a manageable backlog, which I would say is four weeks of orders on hand, and then use distribution to service our customers. And this gives us enough flexibility and also allows us a little safety margin in the event were delayed for a week because of a component or other unforeseen issues. So, ideally, I would like our backlog to be about \$2 million, maybe a little bit less, maybe \$1.8 million at the end of the year, and I think we're on track to achieve that.

Richard Siracusa – Bank of America Merrill Lynch

Thank you. And, secondly, I don't know if you can answer the question, but is there any way to quantify the software developments that are going on with Apple as far as market potential, market size, et cetera?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

The short answer is I think not at this time, but I can give you a few examples. I think the fundamental thing that's different between the Apple environment and the rest of the world is that it is possible to do an application for a targeted market and I can give you one or two examples. And one of the things I did in early October was I went to see our customers in Europe, including the customer who developed the first Apple-certified third-party app, to answer some of the questions that I think you're asking also and we were asking them. They did a hospitality application but their target is for people who are running corporate events between, I would say, 100 and 350 people. And they've done all the software that allows them to check them in, check them out, run marketing campaigns, and better service that group of people. As they explained it to me, there is a lot of software available if you're running a 2,000 person event. And there is very little software if you're running a 300 person event or 100 person event even though people often spends tens and in some cases hundreds of thousands of dollars on these 300 person events. And I think what Apple has enabled people to do is to target a segment of the market. We have people who are collecting wine and other collectables that again can write an app and people can quickly adopt. I went to a large retail customer, they're a large Safeway type company. And they have done an application for their high-end customers that allows them to check out using the iPhone. Now they need a scanner. I think one thing that's particularly exciting is that these middle markets of people who are a group of 500 or 1,000 can write an app that's custom to their requirements and then add scanning and they don't have to buy everyone hardware. And so I don't know if it's one big thing, I think its lots of little things, which is actually much better from our point of view.

And as Dave mentioned, we shipped over 100 SDKs in distribution already. And the people are out there and basically starting the development. It's something we will definitely monitor and we can report on going forward. But today it's still too early as developers tend to be very secretive until they have their product in the market.

Richard Siracusa – Bank of America Merrill Lynch

Right. Right. Okay. Thank you.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com



Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

You're welcome.

Operator

Thank you. Our next question is from line of Mike Schellinger, a private investor. Please go ahead.

Mike Schellinger – Private Investor

Yes. I have two questions. First of all, to what extent beyond the \$800K was revenue constrained by your production capability? Are you in a mode where you're not actively going after customers or at least were not in Q3, just because you had a difficulty in servicing them or can you kind of characterize that?

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Okay. That's an interesting question. We were, in addition to the \$800K that we shipped and didn't recognize, we were probably constrained by at least another \$1 million in that we had orders that we didn't have components for due to the fact of being a few weeks later in the quarter when we got our issues resolved. So I would say there was another \$1 million of shortages on top of the \$800,000.

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

And I think that's reflected in a couple of the comments you've already heard. I'll put the pieces together for you. I mentioned that we left the third quarter with a backlog of about \$3 million and Kevin mentioned in answering some of the question that he's believing about \$1.8 million is about the right level of backlog for us to be carrying. So the difference of \$1.2 million is the extent to which we'll be catching up. And the rest of it depends on the pace of orders coming in. We have seen orders increasing quarter-over-quarter. We did see orders of \$5.7 million this third quarter. So we'll have to see again whether we see continued growth or it flattens, but the current backlog that we should be catching up will be in the \$1 million range.

Mike Schellinger – Private Investor

Okay.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

To answer your question about how much outreach we have done and if we haven't done the outreach... all the outreach we need to do to is to capture the HP customers. And we will pick up the pace of this in Q4, but we felt it was somewhat pointless to go and capture these customers unless we had products to deliver to them when they were ready to go. We will be in that position I would say starting in November and it's our intention to reach out to those customers. We're fortunate in that, overseas in particular and actually in the US, many of our distributors were also distributing the iPAQ. And, therefore, it's not a huge reach to actually run some campaigns to reach out to the existing HP iPAQ customers let them know there are alternatives. We just haven't done that yet.

Mike Schellinger – Private Investor

Okay. Great. And my second question is that the \$800K, is it correct to assume that that's in the \$3 million of backlog or is that an addition to the \$3 million to backlog?

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com
www.investorcalendar.com



David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

That would be in addition.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

It's not a backlog because we've shipped it.

Mike Schellinger – Private Investor

Okay.

David W. Dunlap – Socket Mobile, Inc. – Chief Financial Officer

Once we ship the product to the distributor, we create the receivable, they owe us the money, and they will pay us under normal payment terms but usually, your other side of that receivable become sales. We defer the sales. We also relieve the inventory. The other side of that is typically cost of sales. That gets deferred. So on our balance sheet, you'll see a deferred income on shipments to distributors and that's the net of your sales and cost of sales. Our total inventory in the channel at the end of September was about \$2.4 million, up from about \$1.6 million at the end of the previous quarter. So that was the \$800,000 bulge that you're seeing.

The question is what is the right stockage level in the channels? It's probably about right now as business picks up, but we expect that bulge will work its way through and where it winds up at the end of December will be a function of what the stocking expectations and needs of our distributors are, probably much more so than availability of supply. We expect to be able to be back on a normal delivery schedule by the end of this quarter.

Mike Schellinger – Private Investor

Okay. Thank you. Great.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Thank you very much, Mike.

Operator

Thank you. We have no further questions in the queue at this time. I would like to turn the floor back over to management for closing comments.

Kevin J. Mills – Socket Mobile, Inc. – President and Chief Executive Officer

Okay. Thank you very much. We will just like to thank everyone for their participation in the call today and wish you all a good afternoon. Thank you.

Operator

Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com