Exhibit A-3

Pure Digital's unaudited consolidated balance sheet as of December 31, 2008 and the related consolidated statements of operations and consolidated statements of cash flows for the fiscal year ended December 31, 2008.

Pure Digital Technologies, Inc.
2008 Unaudited Consolidated Balance Sheets
(in thousands)

	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08
Assets												
Cash	$ 46,215	$ 46,437	$ 42,820	$ 27,597	$ 24,086	20,055	$ 13,642	$ 12,809	22,123	$ 18,706	$ 20,142	$ 26,169
Accounts receivable	5,969	3,675	4,430	4,813	8,418	15,247	15,160	9,898	8,353	21,799	40,575	35,007
Inventories	17,695	18,323	18,631	19,677	22,083	25,102	31,734	32,407	37,326	36,733	28,153	19,793
Other current assets	513	541	581	774	765	700	902	764	773	747	663	698
Total Current Assets	70,392	68,975	66,462	52,861	55,352	61,104	61,439	55,879	68,575	77,985	89,533	81,667
Property and equipment	5,963	5,984	6,055	6,087	6,150	6,293	6,333	6,457	6,543	6,617	6,778	6,791
Accumulated depreciation	(4,091)	(4,171)	(4,253)	(4,334)	(4,431)	(4,519)	(4,607)	(4,706)	(4,811)	(4,915)	(5,129)	(5,302)
Property and equipment, net	1,872	1,812	1,802	1,752	1,719	1,774	1,727	1,751	1,732	1,702	1,649	1,489
Total Assets	$ 72,264	$ 70,787	$ 68,264	$ 54,613	$ 57,071	$ 62,878	$ 63,165	$ 57,629	$ 70,307	$ 79,687	$ 91,182	$ 83,156
Liabilities												
Bank debt	$ 13,315	$ 13,222	$ 13,130	--	--	--	--	--	$ 10,000	$ 15,000	$ 15,000	$ 15,000
Accounts payable & other liabilities	22,903	22,638	21,287	20,744	24,267	28,790	27,733	21,530	25,707	26,886	33,352	23,778
Total current liabilities	36,218	35,860	34,416	20,744	24,267	28,790	27,733	21,530	35,707	41,886	48,352	38,778
Long-term liabilities	86	83	65	55	51	41	30	19	9	4	-	-
Total liabilities	36,304	35,944	34,482	20,799	24,318	28,832	27,763	21,549	35,716	41,890	48,352	38,778
Equity												
Retained deficit	(67,234)	(68,351)	(69,412)	(69,386)	(70,464)	(69,178)	(67,822)	(67,144)	(68,633)	(65,428)	(60,394)	(58,845)
Capital	103,194	103,194	103,194	103,200	103,216	103,224	103,224	103,224	103,224	103,224	103,224	103,223
Total Equity	35,960	34,844	33,782	33,814	32,752	34,046	35,402	36,080	34,591	37,797	42,830	44,378
Total Liabilities and Equity	$ 72,264	$ 70,787	$ 68,264	$ 54,613	$ 57,071	$ 62,878	$ 63,165	$ 57,629	$ 70,307	$ 79,687	$ 91,182	$ 83,156

Note:

These unaudited financial statements have been prepared on an internal operating basis and are used to evaluate the Company's financial position and manage overall operations. The statements are prepared in accordance with GAAP consistently applied, excepting the following material departures: (i) the timing and deferral requirements for revenue recognition as required by GAAP including SOP 97-2, EITF 00-21, and FASB 48; and (ii) the expensing of stock options and stock based compensation as required by APB 25, FASB 123 and FASB 123R

Pure Digital Technologies, Inc.
2008 Unaudited Consolidated Statements of Operations
(in thousands)

	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	YTD	Q1 '08	Q2 '08	Q3 '08	Q4 '08
Revenues	$ 5,575	$ 3,576	$ 5,569	$ 7,596	$ 11,482	$ 14,148	$ 10,818	$ 9,387	$ 6,869	$ 20,675	$ 30,330	$ 19,529	$ 145,554	$ 14,721	$ 33,227	$ 27,073	$ 70,534
Cost of goods sold	3,525	2,538	3,945	5,148	7,032	9,656	7,092	5,954	4,668	12,731	19,739	13,157	95,184	10,008	21,836	17,713	45,627
Gross Margin	2,050	1,039	1,625	2,449	4,451	4,492	3,725	3,433	2,202	7,943	10,591	6,372	50,370	4,713	11,391	9,360	24,906
	36.8%	*29.0%*	*29.2%*	*32.2%*	*38.8%*	*31.7%*	*34.4%*	*36.6%*	*32.0%*	*38.4%*	*34.9%*	*32.6%*	*34.6%*	*32.0%*	*34.3%*	*34.6%*	*35.3%*
Operating expenses:																	
Sales and marketing	717	612	678	783	1,609	1,783	1,221	1,168	1,443	1,025	3,230	2,669	16,938	2,007	4,175	3,832	6,924
Research and development	886	862	1,329	944	1,777	1,007	824	880	960	2,114	974	1,133	13,690	3,077	3,727	2,664	4,221
General and administrative	451	636	704	670	876	625	723	717	934	1,103	886	994	9,319	1,791	2,171	2,374	2,983
Total operating expenses	2,054	2,110	2,711	2,397	4,262	3,415	2,767	2,766	3,338	4,243	5,090	4,796	39,948	6,875	10,073	8,871	14,128
EBIT	(4)	(1,072)	(1,087)	52	189	1,077	958	667	(1,136)	3,701	5,502	1,576	10,423	(2,162)	1,318	489	10,778
Other income (expense), net	42	(19)	25	(26)	84	25	10	16	(355)	(500)	(469)	(705)	(1,872)	48	83	(330)	(1,674)
Net income (loss)	$ 38	$ (1,090)	$ (1,062)	$ 26	$ 273	$ 1,103	$ 968	$ 683	$ (1,491)	$ 3,200	$ 5,032	$ 871	$ 8,551	$ (2,114)	$ 1,401	$ 159	$ 9,104
Depreciation & Amortization	$ 88	$ 80	$ 81	$ 81	$ 82	$ 88	$ 88	$ 99	$ 105	$ 104	$ 214	$ 173	$ 1,284	$ 250	$ 251	$ 292	$ 491

Note:
These unaudited financial statements have been prepared on an internal operating basis and are used to evaluate the Company's financial position and manage overall operations. The statements are prepared in accordance with GAAP consistently applied, excepting the following material departures: (i) the timing and deferral requirements for revenue recognition as required by GAAP including SOP 97-2, EITF 00-21, and FASB 48; and (ii) the expensing of stock options and stock based compensation as required by APB 25, FASB 123 and FASB 123R

Pure Digital Technologies, Inc.

2008 Unaudited Consolidated Statements of Cash Flow

(in thousands)

	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	YTD	Q1 '08	Q2 '08	Q3 '08	Q4 '08
Operating Activities																	
Net income (loss)	38	(1,090)	(1,062)	26	273	1,103	968	683	(1,491)	3,200	5,032	871	8,551	(2,114)	1,401	159	9,104
Adjustments to reconcile net loss to net cash used in operating activities:																	
Depreciation and amortization	88	80	81	81	82	88	88	99	105	104	214	173	1,283	250	250	292	491
Accounts receivable	(372)	2,294	(755)	(383)	(3,605)	(6,829)	87	5,261	1,545	(13,446)	(18,776)	5,567	(29,410)	1,168	(10,817)	6,894	(26,654)
Inventory	22	(627)	(308)	(1,046)	(2,406)	(3,019)	(6,632)	(673)	(4,919)	594	8,580	8,360	(2,075)	(914)	(6,471)	(12,224)	17,534
Other current assets	30	(28)	(41)	(192)	9	65	(202)	138	(8)	26	85	(36)	(155)	(39)	(119)	(72)	74
Accounts payable & accrued expenses	6,532	(292)	(1,352)	(542)	3,523	4,523	(1,057)	(6,203)	4,179	1,179	6,466	(9,574)	7,382	4,889	7,504	(3,082)	(1,929)
Other					(1,335)	183	388	(5)	-	6		679	(84)	-	(1,152)	383	685
Net cash provided by (used in) operating activities	6,338	338	(3,436)	(2,057)	(3,460)	(3,886)	(6,362)	(699)	(590)	(8,336)	1,601	6,039	(14,510)	3,240	(9,403)	(7,650)	(696)
Investing Activities																	
Purchase of property and equipment	(73)	(20)	(71)	(32)	(63)	(143)	(40)	(124)	(86)	(74)	(161)	(13)	(901)	(164)	(238)	(250)	(248)
Net cash used in investing activities	(73)	(20)	(71)	(32)	(63)	(143)	(40)	(124)	(86)	(74)	(161)	(13)	(901)	(164)	(238)	(250)	(248)
Financing Activities																	
Net exercise of employee stock options	15	-	-	6	16	8	-	-	-		-	-	45	15	30	-	-
Payments on capital leases	(18)	(2)	(18)	(10)	(4)	(10)	(11)	(11)	(10)	(6)	(4)	-	(104)	(39)	(24)	(32)	(10)
Principal borrowings (payments) on bank debt	(92)	(93)	(93)	(13,130)	-	-	-	-	10,000	5,000	-	-	1,593	(278)	(13,130)	10,000	5,000
Net cash provided by (used in) financing activities	(96)	(95)	(110)	(13,134)	12	(2)	(11)	(11)	9,990	4,994	(4)	-	1,533	(301)	(13,124)	9,968	4,990
Net increase (decrease) in cash	6,169	222	(3,617)	(15,223)	(3,511)	(4,030)	(6,413)	(834)	9,314	(3,416)	1,436	6,027	(13,877)	2,774	(22,765)	2,067	4,046
Cash at beginning of period	40,046	46,215	46,437	42,820	27,597	24,086	20,055	13,642	12,809	22,123	18,706	20,142	40,046	40,046	42,820	20,055	22,123
Cash at end of period	46,215	46,437	42,820	27,597	24,086	20,055	13,642	12,809	22,123	18,706	20,142	26,169	26,169	42,820	20,055	22,123	26,169

Exhibit A-4

Pure Digital's audited balance sheets as of December 31, 2007 and 2006 and the related statements of operations and statements of cash flows for the fiscal years ended December 31, 2007 and 2006.

Pure Digital Technologies, Inc.

Financial Statements
Years ended December 31, 2006 and 2005

BDO Seidman, LLP
Accountants and Consultants

Pure Digital Technologies, Inc.
Contents

BDO Seidman, LLP
Accountants and Consultants

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Independent Auditors' Report

The Board of Directors
Pure Digital Technologies, Inc.
San Francisco, California

We have audited the accompanying balance sheets of Pure Digital Technologies, Inc. as of December 31, 2006 and 2005 and the related statements of operations, stockholders' deficit, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pure Digital Technologies, Inc. at December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As more fully described in Notes 1 and 2, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, and FASB Staff Position 150-5 (FSP 105-5) *Issuer's Accounting under FASB Statement No. 150 for Freestanding Warrants and Other Similar Instruments on Shares that are Redeemable.*

BDO Seidman, LLP

March 6, 2008

Pure Digital Technologies, Inc.
Balance Sheets

December 31,		2006		2005
Assets				
Cash and cash equivalents	$	**6,078,500**	$	6,623,656
Accounts receivable, net		**5,480,965**		4,228,305
Inventories, net		**5,909,374**		2,012,006
Deferred costs of revenues - current portion		**5,648,543**		19,679,481
Prepaid and other current assets		**257,277**		249,190
Total current assets		**23,374,659**		32,792,638
Other Assets		**30,020**		–
Deferred Costs of Revenues, net of current portion		**6,766,483**		9,056,784
Property and Equipment, net		**1,694,716**		1,670,646
Total Assets	$	**31,865,878**	$	43,520,068
Liabilities and Stockholders' Deficit				
Current liabilities:				
Line of credit	$	**8,992,476**	$	9,487,350
Accounts payable and accrued liabilities		**5,284,231**		4,028,184
Capital leases – current portion		**120,138**		24,052
Other current liabilities		**4,763,590**		1,448,593
Term Loan – current portion		**1,111,111**		–
Deferred revenue – current portion		**10,254,998**		35,550,140
Total current liabilities		**30,526,544**		50,538,319
Term Loan, net of current portion		**833,333**		5,000,000
Capital Leases, net of current portion		**103,968**		35,062
Deferred Revenue, net of current portion		**12,139,239**		17,095,749
Other Long Term Liabilities		**74,149**		–
Total Liabilities		**43,677,233**		72,669,130
Stockholders' Deficit:				
Preferred stock, $0.0001 par value. Authorized 52,907,412 and 43,927,839 shares at December 31, 2006 and 2005, respectively; Series A, B, C, D, E and A-1 convertible preferred stock issued and outstanding 50,325,262 and 42,057,641 shares at December 31, 2006 and 2005, respectively.		**5,033**		4,206
Common stock, $.0001 par value; 75,000,000 and 65,000,000 shares authorized at December 31, 2006 and 2005, respectively; issued and outstanding 4,828,422 and 4,710,178 shares as of December 31, 2006 and 2005, respectively		**483**		471
Additional paid-in capital		**71,631,935**		44,378,699
Accumulated deficit		**(83,448,806)**		(73,532,438)
Total Stockholders' Deficit		**(11,811,355)**		(29,149,062)
Total Liabilities and Stockholders' Deficit	$	**31,865,878**	$	43,520,068

See accompanying notes to financial statements.

Pure Digital Technologies, Inc.
Statements of Operations

Years ended December 31,		2006		2005
Revenues	**$**	**75,316,114**	$	2,319,320
Costs and Expenses:				
Cost of revenues		**67,130,986**		22,869,994
Departmental expenses (exclusive of maintenance and support, occupancy costs and depreciation, and payroll and benefits):				
Sales and marketing		**2,136,043**		1,339,322
Research and development		**2,566,109**		3,248,430
General and administrative		**2,252,380**		1,161,073
Occupancy costs and depreciation		**841,119**		718,882
Payroll and benefits		**9,592,638**		13,305,541
Operating expenses		**84,519,275**		42,643,242
Loss from Operations		**(9,203,161)**		(40,323,922)
Interest Expense, net		**(636,267)**		(375,669)
Net Loss	**$**	**(9,839,428)**	$	(40,699,591)

See accompanying notes to financial statements.

Pure Digital Technologies, Inc.
Statements of Stockholders' Deficit

	Series A, B, C, D, E and A-1 Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount			
Balances at January 1, 2005	35,892,353	$ 3,589	6,459,335	$ 646	$ 28,066,277	$ (32,832,847)	$ (4,762,335)
Reclassification of common stock to Series A-1 convertible preferred stock (Note 7)	1,995,638	200	(1,995,638)	(200)	–	–	–
Compensation expense resulting from the exchange of common stock for Series A-1 convertible preferred stock pursuant to the stock reclassification (Note 7)	–	–	–	–	3,256,236	–	3,256,236
Issuance of Series D convertible preferred stock	4,146,641	415	–	–	9,903,768	–	9,904,183
Issuance of common stock warrants to bank	–	–	–	–	54,000	–	54,000
Issuance of common stock upon exercise of options	–	–	304,085	30	13,218	–	13,248
Net issuance Series A-1 convertible preferred stock upon exercise of options	47,697	5	–	–	10,634	–	10,639
Repurchase of unvested shares from terminated employees	(24,688)	(3)	(57,604)	(5)	(8,220)	–	(8,228)
Compensation expense resulting from the modification of employee stock options under variable accounting	–	–	–	–	3,082,786	–	3,082,786
Net loss	–	–	–	–	–	(40,699,591)	(40,699,591)
Balances at December 31, 2005	42,057,641	4,206	4,710,178	471	44,378,699	(73,532,438)	(29,149,062)
Reclassification of preferred stock warrants to liability (Note 2)					(54,000)	(76,940)	(130,940)
Issuance of Series E convertible preferred stock	8,098,377	810	–	–	26,918,521	–	26,919,331
Issuance of common stock upon exercise of options	169,244	17	118,244	12	51,921	–	51,950
Compensation expense resulting from the modification of employee stock options under variable accounting	–	–	–	–	162,210	–	162,210
Stock-based compensation; employee options granted in 2006	–	–	–	–	174,584	–	174,584
Net loss	–	–	–	–	–	(9,839,428)	(9,839,428)
Balances at December 31, 2006	50,325,262	$ 5,033	4,828,422	$ 483	$ 71,631,935	$ (83,448,806)	$ (11,811,355)

See accompanying notes to financial statements.

Pure Digital Technologies, Inc.
Statements of Cash Flows

Years ended December 31,		2006		2005
Cash Flows from Operating Activities				
Net loss	$	**(9,839,428)**	$	(40,699,591)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization		**1,189,295**		1,425,746
Stock-based compensation:				
Employee stock options		**336,794**		3,082,786
Common stock exchanged for Series A-1 convertible preferred stock pursuant to reclassification transaction		**–**		3,256,236
Noncash interest (income) expense		**(19,791)**		54,000
Changes in operating assets and liabilities:				
Accounts receivable		**(1,252,660)**		209,440
Inventories and deferred costs of revenues		**12,450,301**		(21,593,291)
Other current and non-current assets		**(38,107)**		(99,838)
Accounts payable and accrued liabilities		**1,256,047**		696,594
Deferred revenue		**(30,251,652)**		36,390,388
Other current liabilities		**3,277,997**		529,919
Net Cash Used in Operating Activities		**(22,891,204)**		(16,747,611)
Cash Flows from Investing Activities				
Purchases of property and equipment		**(1,029,387)**		(1,372,062)
Net Cash Used in Investing Activities		**(1,029,387)**		(1,372,062)
Cash Flows from Financing Activities				
Proceeds from issuance of preferred stock, net		**26,919,331**		9,904,183
Proceeds from exercise of employee stock options, net		**51,950**		15,659
Net borrowings under line of credit		**(494,874)**		5,045,000
Borrowings under term loan		**–**		5,000,000
Repayments of term loan		**(3,055,556)**		–
Net borrowings under capital leases		**(45,416)**		(13,675)
Net Cash Provided by Financing Activities		**23,375,435**		19,951,167
Net Increase (Decrease) in Cash and Cash Equivalents	$	**(545,156)**	$	1,831,494
Cash and Cash Equivalents, beginning of year		**6,623,656**		4,792,162
Cash and Cash Equivalents, end of year	$	**6,078,500**	$	6,623,656
Supplemental Disclosure of Cash Flow Information				
Cash paid during the year for interest	$	**1,025,776**	$	461,008
Capital equipment acquired under capital lease obligations		**210,408**		48,162

See accompanying notes to financial statements.

1. Significant Accounting Policies

Organization and Summary - Pure Digital Technologies, Inc. (the "Company"), a Delaware corporation formed on November 8, 2000 develops imaging products for mass market consumers. The Company's revenues are derived through two distinct product lines. The single-use products include both digital still cameras and video camcorders. The single-use business also includes the sale of computer hardware containing proprietary software for use in processing and developing digital images captured on its single-use. cameras/camcorders. Single-use products are sold primarily through national and regional drug store chains. During 2006 the Company introduced a digital camcorder labeled "Point & Shoot." Point & Shoot is sold into traditional consumer electronic channels. Customers include a major warehouse membership club along with large general and online retailers. All the Company's products are sold within the United States.

(a) Revenue Recognition

At December 31, 2006 and 2005, the Company had deferred revenues of $22,394,237 and $52,645,889, respectively and deferred costs of $12,415,026 and $28,736,265, respectively.

Single-Use

General Overview. Revenue is derived primarily from multiple element arrangements which provide for the following revenue streams over extended contract periods, generally two to three years from initial rollout:

1) Sale or lease of hardware that includes significant proprietary software ("Servers")

2) Sale of single-use cameras ("camera" or SUC") whose utility is dependent on the Servers

3) Camera processing fees derived from the use of the Server to process digital images captured on SUC

4) Non-reciprocal usage-based fees in the form of the return of processed SUC to the Company

5) Post-contract customer support ("PCS") fees related to Servers and the software embedded therein

Upon entering into multiple element arrangements, the Company's revenue cycle typically begins with the sale or lease of Servers along with related PCS. Retailers subsequently purchase SUC to market and resell to consumers or end-users. The consumer captures digital images or pictures with the SUC and returns it to the retailer for processing. Upon processing, the consumer surrenders the SUC. The retailer is then obligated to return the processed SUC back to the Company for refurbishment. The Company inventories refurbished cameras for resale to retailers.

These multiple element arrangements are within the scope of Statement of Position ("SOP") No. 97-2, *Software Revenue Recognition* ("SOP 97-2"), and the Emerging Issues Task Force Issue 03-5, *Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software* ("EITF 03-05"). The Company has determined that the software is essential to the functionality of the hardware elements (including the servers and cameras) and, accordingly, these hardware elements are deemed to be software-related.

Servers. Inasmuch as there is no vendor-specific objective evidence ("VSOE") of the fair value of the Servers, specified software upgrades, and PCS deliverables, contractually stipulated billable amounts for those deliverables are recognized ratably over the PCS service periods, which generally range from two to three years, commencing at the time PCS services are the only undelivered element. Under the cumulative catch-up method, once PCS is the only remaining deliverable in the arrangement, the Company immediately recognizes revenue based on the ratio of the PCS services period already expired to the total PCS service period. The remaining amount is recognized ratably over the remaining PCS service period.

SUC Deliverables. The sale of a SUC represents a prepaid, usage-based, software fee given that upon processing of the digital images stored therein, the camera must be returned to the Company. While consumers may choose not to surrender the camera for processing, the right to use the Company's Server technology has been effectively prepaid via the camera's contractual non-refundable sales price, billable upon delivery.

AICPA Technical Practice Aid 5100.76 ("TPA") discusses revenue recognition for software usage-based fees when there is no VSOE of fair value of the PCS and consequently the residual method cannot be used to determine the fee allocable to software license. The TPA concludes that the usage-based fee should be recognized at the time a reliable estimate can be made of the actual usage that has occurred, provided collectibility is probable. Accordingly, when the only remaining undelivered software element is PCS; the usage-based software fee represented by the camera deliverable is recognizable at the time the risk of loss for them is transferred to the retailer.

Prior to PCS services being the only remaining software-related deliverable, contractual amounts billed for SUC usage-based fees are deferred and are recognized using the cumulative catch-up method at the time PCS services become the only undelivered element.

During 2006, revenue of $19,690,238 (2005: $0) and cost of goods sold of $12,537,089 (2005: $0) was recognized using the cumulative catch up method upon removal of the Company's obligation to provide certain software elements for which VSOE did not exist.

Camera Processing Fees. The contingent usage-based fee in the form of the monetary charge for processing is recognized in the period such processing takes place. Prior to PCS services being the only remaining software-related deliverable, contractual amounts billed for processing fees are deferred and are recognized using the cumulative catch-up method at the time PCS services become the only undelivered element.

Non-reciprocal Returns. Contingent usage-based fees in the form of a non-reciprocal return of a SUC from a customer are accounted for pursuant to the provisions of APB 29, *Accounting for Nonmonetary Transactions ("APB 29").* Once a SUC has been returned to the Company, successfully refurbished, and made available for resale, revenue is recognized along with a corresponding increase to finished goods inventory. Pursuant to APB 29, recorded amounts are based on the camera's net realizable value (estimated selling price or fair market value less costs to refurbish). Similar to the revenue recognition pattern for Servers described above, amounts recognized for contingent usage-based fees related to returned cameras are deferred and are recognized using the cumulative catch-up method at the time PCS services become the only undelivered element.

PCS. PCS service fees are billed monthly. Prior to PCS services being the only remaining software-related deliverable, contractual amounts billed for PCS are deferred. At the time PCS services become the only undelivered element, the cumulative deferral is recognized and subsequent billings are recognized monthly.

As of December 31, 2006, the Company had not delivered specified applications promised to a large customer. As a result, all revenues related to this arrangement have been deferred.

<u>**Point & Shoot Camcorder**</u>

In April 2006 the Company began selling a digital camcorder labeled "Point & Shoot" that provides an end to end solution for creating, sharing and archiving home movies.

The Company records revenue from Point & Shoot under the guidance of Staff Accounting Bulletin No. 104, *Revenue Recognition* ("SAB 104"). SAB 104 requires four basic criteria be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the seller's price to the buyer is fixed or determinable; and, (4) collectibility is reasonably assured.

Although retailers have a limited right to return camcorders, the Company does not currently have sufficient historical evidence to reasonably estimate future returns. Thus, in accordance with Statement of Financial Accounting Standard No. 48 *Revenue Recognition When a Right of Return Exists*, once the criteria of SAB 104 has been met, Point & Shoot revenue is recognized when camcorders are sold through retail to the consumer.

(b) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Estimates include the allowance for doubtful accounts, the amortization period of deferred contract revenue and related costs, the net realizable values of cameras, and the valuation of equity-based financial instruments including stock options and warrants.

(c) Cash Equivalents

All highly liquid investments purchased with an original maturity of three months or less are classified as cash and cash equivalents. Cash equivalents consist of cash held in a bank money market account.

(d) Accounts Receivable

Accounts receivable include customer obligations due under normal trade terms, generally net 30 to 60 days. Senior management reviews accounts receivable on a monthly basis to estimate the potential risk of any account being uncollectible. Any accounts that are determined to be uncollectible are included in an allowance for doubtful accounts. The allowance for doubtful accounts at December 31, 2006 and 2005 was $40,750 and $71,050 respectively.

(e) Property and equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation of property and equipment, including leased assets, is computed using the straight-line method over the estimated useful lives of the assets ranging from two to ten years. Leasehold improvements are amortized on a straight-line basis over the lesser of the estimated useful life of the asset or the lease term.

(f) Inventories

Inventories are stated at the lower of cost or market and are comprised of component parts and finished goods including Servers along with new and refurbished cameras. Cost is determined on a weighted average basis for parts, servers and new cameras..

As discussed above, the Company records the non-reciprocal, non-monetary return of processed SUC in accordance with APB 29. Pursuant to APB 29, processed cameras returned from customers, once fully refurbished, are recorded as inventory at fair value.

(g) Deferred Costs of Revenue

Deferred costs of revenues represent product costs directly associated with deferred revenues and are charged to cost of revenues as deferred revenues are recognized (see *Revenue Recognition* above).

(h) Income Taxes

Income taxes are accounted for in accordance with SFAS No. 109, *Accounting for Income Taxes.* Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting amount and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based upon enacted tax laws and rates in effect for the year in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to an amount that is more likely than not to be realized.

(i) Impairment of Long-Lived Assets

The Company evaluates its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets or intangibles may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of their carrying amount to their future undiscounted net cash flows. If such assets are deemed to be impaired, the impairment charge to be recognized would be equal to the amount by which the carrying amount of the assets exceeds their fair value. There was no impairment of long lived assets during 2006 and 2005.

(j) Shipping and Handling Costs

Costs associated with shipping and handling activities are charged to cost of revenues. Shipping and handling costs billed to customers are included in revenues.

(k) Advertising Costs

The Company expenses advertising costs as incurred. For the years ended December 31, 2006 and 2005, advertising costs were approximately $521,556 and $466,607, respectively.

(l) Research and Development

Product research and development expenditures are charged to expense as incurred.

(m) Stock-Based Compensation

The Company accounts for stock-based compensation arrangements with non-employees in accordance with Statements on Financial Accounting Standards No. 123 and Emerging Issues Task Force Abstract No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. Accordingly, unvested options and warrants held by non-employees are subject to revaluation at each balance sheet date based on the then current fair market value.

On January 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, ("SFAS 123R") which requires the measurement and recognition of compensation expense for all stock-based awards made to employees and directors on estimated fair values. SFAS 123R supersedes the previous accounting under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), as allowed under Statement of Financial Accounting Standards No. 123, *Accounting for Stock – Based Compensation* ("SFAS 123").

As a nonpublic entity that used the minimum value method for disclosure purposes under SFAS 123 the Company has applied SFAS 123R prospectively. New awards and awards modified, repurchased or cancelled on or after January 1, 2006 have been accounted for under SFAS 123R. Awards outstanding on December 31, 2005 have been accounted for using the accounting principles originally applied to those awards (APB 25).

In accordance with prospective transition method the Company's financial statements for periods prior to 2006 have not been restated to reflect, and do not include, the impact of SFAS 123R.

SFAS 123R requires companies to estimate the fair value of stock-based awards on the date of grant using an option pricing model. The Company uses the Black-Scholes-Merton option pricing model to determine the fair value of stock options under SFAS 123R. The value of the portion of the stock based award that is ultimately expected to vest is recognized as expense on a straight line basis over the requisite service period.

SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's calculation of stock based compensation required under APB 25, the Company accounted for forfeitures as they occurred.

As a result of adopting SFAS 123R, stock-based compensation expense for 2006 was $174,585, or $174,585 higher than what would have been reported under APB 25. Net Loss for 2006 was $174,584 lower than that which would have been reported had the Company continued to account for stock-based compensation under APB 25.

As a nonpublic entity with no observable market prices for its securities, the Company has used the services of an independent valuation specialist to determine the fair market value of its securities.

(See Note 7 for additional information on stock-based compensation.)

(n) Point & Shoot Warranty

The Company provides consumers with a ninety day warranty on its Point & Shoot camcorders for defects in materials or workmanship. Statement of Financial Accounting No.5, *Accounting for Contingencies ("SFAS 5")*, requires that warranty expense be recorded at the time a product is sold, if it is probable that claims will be made under the warranty and the amount can be estimated. At December 31, 2006 the Company had an estimated current liability of $44,332 (2005: $0) related to estimated warranty claims.

(o) Sales incentives

The Company records reductions to revenue for estimated commitments related to sales incentive programs, including retailer sell-through rebates, consumer rebates, and other sales programs. The estimated cost of these programs is accrued as a reduction to revenue at the later of the date at which the related revenue is recognized or date at which the sales incentive is offered. Estimates are based on specific knowledge of incentives offered to retailers.

(p) New Accounting Standards

In June 2006, the FASB issued Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109.* This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. For non-public entities such as the Company, the FASB has postponed the required effective date of the Interpretation from fiscal years beginning after December 31, 2006 to fiscal years ending after December 15, 2007. The Company is currently assessing the impact of the Interpretation on its financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS 157 replaces the different definitions of fair value in the accounting literature with a single definition. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 is effective for fair-value measurements already required or permitted by other standards for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. On November 14, 2007, the FASB agreed to partially defer the effective date of the standard for certain non-financial assets and liabilities. As of December 31, 2006, the Company does not believe the adoption of SFAS 157 will impact the amounts reported in the financial statements. However, additional disclosures will be required about the inputs used to develop the measurements of fair value and the effect of certain of the measurements reported in the statement of operations for a fiscal year.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 would allow the Company a one-time irrevocable election to measure certain financial assets and liabilities on the balance sheet at fair value and report the unrealized gains and losses on the elected items in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument, with a few exceptions, and is applied only to entire instruments and not to portions of instruments. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating this Statement and has not yet determined the financial assets and liabilities for which the fair value option would be elected or the potential impact on the financial statements, if such election were made.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements*. The standard requires all entities to report noncontrolling (minority) interests in subsidiaries in the same way as equity in the consolidated financial statements. In addition, SFAS No.160 eliminates the diversity that currently exists in accounting for transactions between noncontrolling interests by requiring that they be treated as equity transactions. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact of SFAS No. 160 on its financial position and results of operations.

(q) Reclassifications

Certain prior year amounts have been reclassified for consistency with the current year presentation.

2. Cumulative Effect of Change in Accounting Principle

On June 29, 2005, the FASB issued Staff Position 150-5, *Issuer's Accounting under FASB Statement No. 150* ("SFAS 150") *for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable* ("FSP 150-5"). FSP 150-5 requires the Company to record the fair value of its outstanding preferred stock warrants as liabilities on its balance sheet and record changes to the fair value in its statement of operations at each reporting period.

The Company adopted FSP 150-5 on January 1, 2006. At that time the Company recorded a liability of $130,940 representing the fair value of its preferred stock warrants on that date.

At December 31, 2006 the fair value of the preferred stock warrants decreased to $111,149. Likewise, the company reduced the value of its warrant liability and recorded an offsetting gain to interest income totaling $19,791. At December 31, 2006, warrant liabilities of $37,000 and $74,149 are reflected in the balance sheet other current and other long-term liabilities, respectively.

3. Inventories

Inventories consists of the following:

December 31,	**2006**	2005
Parts	**$ 2,465,667**	$ 1,852,858
Finished goods	**3,443,707**	159,148
	$ 5,909,374	$ 2,012,006

At December 31, 2006 and 2005, finished goods inventory included Point & Shoot camera inventory of $2,621,873 and $0, respectively. At December 31, 2006 and 2005, parts inventory included Point & Shoot components of $53,662 and $0, respectively.

4. Property and Equipment, net

Property and equipment, net, consist of the following:

December 31,	**2006**	2005
Leased assets to customers	**$ 1,489,600**	$ 1,295,877
Computers, hardware, and equipment	**1,978,990**	1,536,281
Software	**349,690**	146,355
Furniture and fixtures	**262,694**	114,311
Leasehold improvements	**100,121**	83,722
Maintenance and support hardware	**484,344**	451,737
	4,665,439	3,628,283
Less accumulated depreciation and amortization	**(2,970,723)**	(1,957,637)
	$ 1,694,716	$ 1,670,646

5. Debt

The Company has a Loan and Security Agreement ("Debt Agreement") with a bank providing the Company with a revolving line of credit ("Line"). Advances against the Line are subject to a borrowing base of up to 80% of eligible accounts as defined in the Debt Agreement. The Line is collateralized by the assets of the Company excluding its intellectual property. Interest accrues on the outstanding principal balance at the Prime Rate plus 0.5% per annum.

On April 26, 2005, the Company amended the Debt Agreement wherein the borrowing limit under the Line was increased to $10,000,000 and the Line maturity date was extended to March 31, 2006.

On September 1, 2005, the Company further amended the Debt Agreement. Pursuant to this amendment, the bank extended the Line maturity date to October 1, 2006. In addition, the bank extended a $5,000,000 interest only term loan ("Term Loan") with an initial maturity date of March 1, 2007. The Term Loan bears interest at the Prime Rate plus 1% per annum payable monthly. In addition, the Company issued to the bank, warrants to purchase 82,932 shares of Series D Preferred stock at an exercise price of $2.41159 per share. The estimated fair value of the warrants on the date of issuance was determined to be approximately $54,000 using the Black-Scholes option pricing model, based on the following assumptions: volatility – 38%; dividend yield – 0%; risk-free interest rate – 4.190%; and expected term – 4 years. This amount was included in additional paid in capital and is being amortized into interest expense over the expected term of the Term Loan.

On adoption of FSP 150-5 on January 1, 2006 the Company reclassified the warrant to purchase 82,932 shares of Series D Preferred stock from additional paid in capital to a long term liability at its then current fair value of $69,827. On December 31, 2006 the warrant had a fair value of $47,927 and in accordance with FSP 150-5 the liability was reduced by $21,900 to $47,927.

On June 30, 2006, the Company amended the Debt Agreement with the Bank, thereby increasing the amounts available under the Line to $12,500,000 and extending the maturity date to April 1, 2008. In addition, beginning in July 2006, the Company began making equal monthly principal payments on the Term Loan through September 2008.

At December 31, 2006 and 2005, the outstanding balances on the Line were $8,987,350 and $9,487,350, respectively. The Prime rates were 8.75% and 7.25% at December 31, 2006 and 2005, respectively. As of December 31, 2006 the Company was in compliance with all but two of its financial covenants. The Company subsequently obtained a waiver of compliance from the bank.

6. Income Taxes

December 31,		2006		2005
Current deferred tax assets (liabilities):				
Accrued liabilities	$	**576,587**	$	164,000
Single-use deferred revenue, net of related costs		**1,994,081**		6,798,990
Point & Shoot deferred revenue, net of related costs		**296,092**		–
State taxes		**7,140**		5,183
Other		**1,517,016**		55,000
Net current deferred tax assets (liabilities)		**4,390,916**		7,023,173
Noncurrent deferred tax assets (liabilities):				
Federal and state net operating losses		**25,332,112**		17,904,000
Deferred revenue, net of related costs		**2,301,689**		3,443,893
Tax credits		**1,601,316**		1,207,000
State taxes		**(2,358,386)**		(2,142,985)
Depreciation and amortization		**3,444**		(77,000)
Other		**2,356**		5,000
Net noncurrent deferred tax assets		**26,882,531**		20,339,908
Net deferred tax assets before valuation allowance		**31,273,447**		27,363,081
Valuation allowance		**(31,273,447)**		(27,363,081)
Net deferred tax assets	$	**–**	$	–

No tax benefit from net operating losses and other deferred tax assets has been recorded through the year ended December 31, 2006. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The Company established a 100% valuation allowance at December 31, 2006 and 2005 due to the uncertainty of realizing future tax benefits from its net operating loss carryforwards and other deferred tax assets. The increase in valuation allowance was approximately $3,910,336 and $13,829,000 the years ended December 31, 2006 and 2005, respectively.

At December 31, 2006, the Company has federal and state net operating loss carryforwards of approximately $60,116,000 and $55,348,000 respectively, expiring beginning in 2020 and 2011, respectively.

The difference between the effective tax rate and the statutory tax rate is primarily due to the net change in the valuation allowance.

Internal Revenue Code Section 382 places a limitation (the "Section 382 Limitation") on the amount of taxable income, which can be offset by net operating loss ("NOL") carryforwards after a change in control (generally greater than 50% change in ownership) of a loss corporation. California has similar rules. Generally, after a control change, a loss corporation cannot deduct NOL carryforwards in excess of the Section 382 Limitation. Due to these "change in ownership" provisions, utilization of the NOL and tax credit carryforwards may be subject to an annual limitation regarding their utilization against taxable income in future periods.

7. Stockholders' Deficit

(a) Stock Reclassification; Variable Accounting

In connection with the Company's Series D convertible preferred stock financing in March of 2005, the Board of Directors approved a "reclassification" of common stock wherein a portion of common stock was exchanged, or reclassified into Series A-1 convertible preferred stock. Pursuant to the reclassification, persons holding shares of common stock on March 4, 2005 automatically had 30% of these shares exchanged for shares of Series A-1 convertible preferred stock. The effect of the reclassification decreased the number of outstanding shares of common stock, and increased Series A-1 convertible preferred stock, by 1,995,638 shares.

The reclassification was also extended to the holders of options to purchase common stock thereby decreasing the number of outstanding options to purchase common stock, and increasing options to purchase Series A-1 convertible preferred stock, by 1,491,896 shares.

Compensation Expense. Pursuant to the reclassification, in 2005 the Company recorded compensation expense of $3,256,236 related to employees who owned common stock on the date of the reclassification. The amount of compensation expense was measured based on the incremental difference between the estimated fair values of the common stock and Series A-1 convertible preferred stock on March 4, 2005 multiplied by 1,995,638 shares. The expense is included in payroll and benefits in the Company's statement of operations.

Variable Accounting. As discussed above, the reclassification also extended to holders of common stock options. Although the aggregate exercise price of each option award remained the same, the per share exercise price of each option award changed.

The table below shows the effect of the reclassification on the range of exercises prices as of March 4, 2005:

Exercise Price Before Reclassification	Exercise Price After Reclassification	
Common	Common	Series A-1
$0.05	$0.0011	$0.1641
$0.10	$0.0022	$0.3282
$0.20	$0.0044	$0.6564
$0.75	$0.0077	$1.1486

As discussed in Note 1, prior to January 1, 2006 the Company accounted for its stock-based awards using the intrinsic value method in accordance with APB No. 25 and its related interpretations. Pursuant to the guidance of FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation; an interpretation of APB Opinion No.25* ("FIN 44"), the reclassification constituted a modification to the effected stock option awards as the ratio of the exercise price per share to the fair value per share was reduced. The resulting modification created a new measurement of compensation cost for each affected option award and requires each award to be subject to variable accounting. Pursuant to FIN 44, a compensation cost equal to the intrinsic value of the modified award shall be recognized over the remaining service or vesting period of the award. Further, compensation cost shall be adjusted for increases or decreases in the intrinsic value of the modified award in subsequent periods until that award is exercised, is forfeited, or expires unexercised.

For the year ended December 31, 2006 the Company's net income included expense of $162,210 relating to the variable accounting of its stock option awards. For the year ended December 31 2005, the Company recognized stock-based compensation expense of $3,082,786 related to the variable accounting of its stock option awards. The expense is included in payroll and benefits in the Company's statement of operations.

(b) Common Stock Reserved for Future Issuance

The Company has reserved the following shares of common stock for issuance in connection with:

December 31,	**2006**	2005
Conversion of Series A convertible preferred stock	**8,345,287**	8,345,287
Conversion of Series A-1 convertible preferred stock	**2,187,891**	2,018,647
Conversion of Series B convertible preferred stock	**15,773,518**	15,773,518
Conversion of Series C convertible preferred stock	**11,773,548**	11,773,548
Conversion of Series D convertible preferred stock	**4,146,641**	4,146,641
Conversion of Series E convertible preferred stock	**8,098,377**	–
Options issued and outstanding	**8,417,942**	5,651,453
Options available for grant under stock option plan	**3,730,911**	1,284,886
Warrants to purchase common stock	**94,035**	94,035
Warrants to purchase Series A-1 preferred stock	**40,301**	40,301
Warrants to purchase Series C preferred stock	**67,924**	67,924
Warrants to purchase Series D preferred stock	**82,932**	82,932
Total	**62,759,307**	49,279,172

(c) Convertible Preferred Stock

Convertible preferred stock ("Preferred Stock") at December 31, 2006 consists of the following:

Series	**Shares Issued and Outstanding**	**Aggregate Liquidation Preference**
A	8,345,287	$ 4,022,062
B	15,773,518	10,999,978
C	11,773,548	12,999,999
D	4,146,641	9,999,998
E	8,098,377	26,999,989
A-1	2,187,891	5,276,296

Significant terms of the preferred stock are as follows:

Conversion.- Each share of Series A, Series B, Series C, Series D, Series E and Series A-1 convertible preferred stock shall be convertible into Common stock by the holder thereof, at any time after the date of issuance of such share. The conversion rate is determined by dividing the original issue price of such series by the applicable conversion price of such series. The original issue price initially is $0.481956, $0.69737 and $1.10417 per share for Series A, Series B, and Series C convertible preferred stock, respectively, $2.41159 per share for both Series D and Series A-1 convertible preferred stock and $3.334 for Series E convertible preferred stock. The initial conversion price per share for each series of preferred stock shall be the original issue price, subject to adjustment for certain dilutive issuances, splits and combinations, and approval by the Board of Directors.

Each share of Series A, Series B, Series C, Series D, Series E and Series A-1 convertible preferred stock shall automatically be converted into one share of common stock at the then effective conversion price applicable to such series immediately upon the earlier of (i) closing of a firm commitment underwritten public offering of greater than $25 million or (ii) the date specified by written consent or agreement of the holders of a majority of the then outstanding shares of preferred stock to the conversion of all then outstanding preferred stock.

Dividends - Holders of the Company's Series A, Series B, Series C, Series D, Series E and Series A-1 preferred stock are entitle to receive, when declared by the Board of Directors, annual dividends at the rate per annum of $0.029, $0.042, $0.06625, $0.1447, $0.20 and $0.1447, respectively, as applicable, per share of such stock held (as adjusted for stock splits, stock combinations, stock dividends and recapitalizations), out of funds legally available. Dividends are not cumulative. No dividends have been declared.

The holders of preferred stock shall be entitled to receive dividends prior to, and in preference to, any declaration or payment of any dividend, in the following declining order of preference: Series E preferred stock, Series D preferred stock, Series C preferred stock, Series B preferred stock, Series A preferred stock, Series A-1 preferred stock, common stock.

Voting - On all matters, the holders of shares of common stock and Series A, Series B, Series C, Series D, Series E and Series A-1 preferred stock, shall vote together as a single class on an as converted basis.

Liquidation - In the event of any liquidation, dissolution or winding up of the Company (including a merger, reorganization or other transaction in which more than 50% of the outstanding voting power of the Company is transferred), the holders of Series E preferred stock shall be entitled to receive, in preference to the holders of the Series A, Series B, Series C, Series D and Series A-1 preferred stock, an amount per share equal to the sum of (a) the original purchase price per share, plus (b) all declared but unpaid dividends on such share. The holders of the Series D preferred stock shall be entitled to receive, in preference to the holders of the Series A, Series B, Series C and Series A-1 preferred stock and Common Stock, an amount per share equal to the sum of (a) the original purchase price per share plus (b) all declared but unpaid dividends on such share. The holders of the Series C preferred stock shall be entitled to receive, in preference to the holders of the Series A, Series B and Series A-1 preferred stock and Common Stock, an amount per share equal to the sum of (a) the original purchase price per share plus (b) all declared but unpaid dividends on such share. The holders of the Series B preferred stock will then be entitled to receive, in preference to the holders of the Series A and Series A-1 preferred stock and Common Stock, an amount per share equal to the sum of (a) the original purchase price per share plus (b) all declared but unpaid dividends on such share. The holders of the Series A preferred stock will then be entitled to receive, in preference to the holders of Series A-1 preferred stock and the Common Stock, an amount per share equal to the sum of (a) the original purchase price per share plus (b) all declared but unpaid dividends on such share. The holders of the Series A-1 preferred stock will then be entitled to receive, in preference to the holders Common Stock, an amount per share equal to the sum of (a) the original purchase price per share plus (b) all declared but unpaid dividends on such share. The balance of the proceeds shall be paid to the holders of the Common Stock.

(d) Series D Convertible Preferred Stock

On the March 4, 2005 the Company issued 4,146,641 shares of Series D convertible preferred stock and received proceeds, net of issuance costs, totaling $9,904,183. In connection with Series D Preferred Stock offering, the Board of Directors and stockholders of the Company approved the filing of an Amended and Restated Certificate of Incorporation (the "Restated Certificate"). Effective as of the filing of the Restated Certificate on March 4, 2005, the Company:

- Increased the total number of authorized shares of common stock to 65,000,000;
- Increased the total number of authorized shares of preferred stock to 43,927,839
- Designated 4,250,000 shares as Series D preferred stock;
- Designated 3,717,562 shares as Series A-1 preferred stock.

(e) Series E Convertible Preferred Stock

On March 7, 2006, the Company issued 8,098,377 shares of Series E convertible preferred stock and received proceeds, net of issuance costs, totaling $26,919,331. In connection with Series E Preferred Stock offering, the Board of Directors and stockholders of the Company approved the filing of an Amended and Restated Certificate of Incorporation (the "Restated Certificate"). Effective as of the filing of the Restated Certificate on March 3, 2006, the Company:

- Increased the total number of authorized shares of common stock to 75,000,000;
- Increased the total number of authorized shares of preferred stock to 52,907,412
- Limited to 4,229,573 shares for Series D preferred stock;
- Designated 9,000,000 shares as Series E preferred stock.

(f) Warrants

Certain Series A preferred stockholders may purchase warrants with the right to purchase Common stock at an exercise price of $0.05 per share. The warrants expire in April 2007. Pursuant to the Reclassification, on March 4, 2005, the then outstanding and available warrants were automatically reclassified into warrants to purchase common stock and Series A-1 convertible preferred stock. As of December 31, 2006 and 2005, 23,601 common stock warrants and 10,115 Series A-1 preferred stock warrants remained available for purchase.

In September 2004, a warrant to purchase 67,924 shares of Series C preferred stock was granted to the Company's bank pursuant to the Debt Agreement. The warrant has an exercise price of $1.10417 per share and expires on September 28, 2011.

In September 2005, a warrant to purchase 82,932 shares of Series D preferred stock was granted to the Company's bank pursuant to the Debt Agreement. The warrant has an exercise price of $2.41159 per share and expires on September 28, 2012 (See *Debt note).*

As discussed in Note 2 on January 1, 2006, the Company reclassified the freestanding preference stock warrants as long term liabilities at their fair market value of $130,941. In accordance with FSP 150- 5 the Company adjusts these warrants to their fair market value at each reporting date. At December 31, 2006, the fair value of the freestanding preference warrants was $111,149. For the year ended December 31, 2006, the Companies net interest expense included a gain of $19,791 to reflect the decrease in the fair value of the preferred stock warrants.

(g) Stock Plan

Under the Company's 2002 Stock Plan (the "Plan") the Company allows selected persons to acquire a proprietary interest in the success of the Company by purchasing shares of the Company's common stock. The Plan provides for both the direct award and sale of shares and for the grant of options to purchase shares.

(h) Stock Awards or Sales

The Plan allows the Company to award or sell shares of common stock to selected persons. Each direct award or sale shall be evidenced by a Stock Purchase Agreement containing the terms and conditions deemed appropriate by the Board of Directors. The purchase price of shares offered under the Plan, as determined by the Board of Directors, shall not be less than 85% of the fair market value of such shares. Purchased shares shall be subject to special forfeiture provisions, rights of repurchase, rights of first refusal and other transfer restrictions as determined by the Board of Directors. There we no stock awards or sales under the Plan during 2006 or 2005.

(i) Stock Options

The Plan provides for grants of both incentive ("ISO") and non-statutory ("NSO") stock options to employees, directors and consultants. However only employees of the Company are eligible to receive ISO's. Options granted pursuant to the Plan generally have a ten-year term and vest over a four-year period. Vesting may be accelerated under certain change of control provisions. The Board of Directors has full authority and discretion to take any actions it deems necessary or advisable for the administration of the Plan.

Options are executable at their exercise price and are non-transferable. The exercise price of an ISO shall not be less than 100% of the fair market value per share on the date of grant. The exercise price of a NSO shall not be less than 85% of the fair market value per share on the date of grant. Subject to the guidelines above, the exercise price under any option shall be determined by the Board of Directors at its sole discretion.

As a nonpublic entity with no observable market prices for its securities, the Company has used the services of an independent valuation specialist to determine the fair market value of its securities.

A summary of stock option activity under the Plan is as follows:

	Number of Common Shares Options	Common Shares Option Weighted Average Exercise Price	Number of Preferred A-1 Shares Option	Preferred A-1 Options Weighted Average Exercise Price
Outstanding – January 1, 2005	5,049,783	$ 0.0900	–	$ –
Granted (weighted average fair value of $0.02 per share)	1,636,217	0.7000	–	–
Stock reclassification of common stock to Series A-1 convertible preferred stock	(1,491,896)	0.4200	1,491,896	0.3800
Exercised	(304,088)	0.0014	(47,697)	0.2100
Forfeited	(636,184)	0.5700	(46,578)	0.2200
Outstanding – December 31, 2005	4,253,832	$ 0.1800	1,397,621	$ 0.4200
Granted (weighted average fair value of $0.28 per share)	3,358,000	0.7700	–	–
Exercised	(118,244)	0.0455	(169,244)	0.2800
Forfeited	(247,717)	0.2600	(56,306)	0.4600
Outstanding – December 31, 2006	7,245,871	$ 0.4500	1,172,071	$ 0.4400
Available for grant at December 31, 2006	3,603,337		127,574	

The total intrinsic value of common share options exercised during the years ended December 31, 2006 and 2005 was $81,079 and $83,302, respectively. The total intrinsic value of preferred A-1 share options exercised during the years ended December 31, 2006 and 2005 was $218,099 and $104,710, respectively.

As of December 31, 2006, there was $786,365 of unrecognized compensation costs related to non-vested stock options. This amount is expected to be recognized over a weighted average period of 2.84 years.

Of the unrecognized compensation costs, $543,730 related to the unvested portion of grants awarded after January 1, 2006, is expected to be recognized over a weighted average period of 3.41 years.

Unrecognized compensated costs of $242,635 related to the unvested portion of grants prior to January 1, 2006, is expected to be recognized over a weighted average period of 1.54 years. As such awards are subject to variable accounting, the estimate of unrecognized compensation costs is based on the intrinsic value of these awards as of December 31, 2006.

Additional information with respect to stock options outstanding at December 31, 2006, is as follows:

	Common Options Outstanding			Common Options Vested and Exercisable	
Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 0.0011	938,855	5.42	$ 0.0011	938,855	$ 0.0011
0.0022	800,275	6.99	0.0022	602,072	0.0022
0.0044	1,181,785	7.59	0.0044	694,735	0.0044
0.0077	52,500	7.91	0.0077	27,492	0.0077
0.0122	14,000	8.17	0.0122	6,420	0.0122
0.7500	1,205,456	8.67	0.7500	376,057	0.7500
0.7700	3,053,000	9.45	0.7700	254,415	0.7700
	7,245,871	8.21	$ 0.4504	2,900,046	$ 0.1668

	Preferred A-1 Options Outstanding			Preferred A-1 Options Vested and Exercisable	
Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 0.1641	335,367	5.44	$ 0.1641	335,367	$ 0.1641
0.3282	312,975	6.97	0.3282	228,066	0.3282
0.6564	495,229	7.59	0.6564	286,537	0.6564
1.1486	22,500	7.91	1.1486	11,784	1.1486
1.8050	6,000	8.17	1.8050	2,752	1.8050
	1,172,071	6.82	$ 0.4432	864,506	$ 0.3892

	Common Options Outstanding			Common Options Vested and Exercisable	
Exercise Price	Number Outstanding	Weighted Average Intrinsic Value	Aggregate Intrinsic Value	Number Exercisable	Aggregate Intrinsic Value
0.0011	938,855	0.75		938,855	
0.0022	800,275	0.75		602,072	
0.0044	1,181,785	0.75		694,735	
0.0077	52,500	0.74		27,492	
0.0122	14,000	0.74		6,420	
0.7500	1,205,456	0.00		376,057	
0.7700	3,053,000	0.00		254,415	
	7,245,871	0.31	$ 2,231,994	2,900,046	$ 1,696,478

	Preferred A-1 Options Outstanding			Preferred A-1 Options Vested and Exercisable	
Exercise Price	Number Outstanding	Weighted Average Intrinsic Value	Aggregate Intrinsic Value	Number Exercisable	Aggregate Intrinsic Value
0.1641	335,367	0.92		335,367	
0.3282	312,975	0.75		228,066	
0.6564	495,229	0.42		286,537	
1.1486	22,500	0.00		11,784	
1.8050	6,000	0.00		2,752	
	1,172,071	0.64	$ 752,237	864,506	$ 600,000

(j) Additional Stock Plan Information

SFAS No. 123R requires the use of a valuation model to calculate the fair value of stock based awards. The fair value of stock-based awards to employees is calculated through the use of option pricing models. The Company utilizes these models even though they were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, unlike the Company's stock option awards. Additionally, these models require subjective assumptions regarding the expected period from grant to exercise which can significantly affect the calculated values.

From January 1, 2006 the Company has elected to use the Black-Scholes-Merton option pricing model, which incorporates various assumptions including volatility, expected life, and risk- free interest rates. The Company's fair value calculations are based on a single-option approach.

As a nonpublic corporation the Company does not have sufficient historical information to estimate expected volatility. In accordance with the provisions of SFAS 123R volatility has been calculated with reference to the volatility of similar public entities.

To determine the expected term of employee stock options, the Company utilized the simplified approach as defined by SEC Staff Accounting Bulletin No. 107, *Share-Based Payment.* As such, forfeitures of unused and unvested awards are estimated based on the Company's historical option activity. The risk-free interest rate is based on Treasury bill rates with a maturities approximating the contractual option term.

The assumptions used and the resulting estimates of weighted average fair value per share of options granted during 2006 are summarized as follows:

	2006
Dividend yield	None
Risk-free interest rate	4.80 %
Expected term, in years	6.25
Volatility	45.00 %

Prior to January 1, 2006 the Company's fair value calculations were made using the minimum value method.

8. Risks, Concentrations, and Uncertainties

The Company's financial instruments, which potentially subject the Company to credit risk, consist primarily of cash and cash equivalents and accounts receivable from customers. The Company does not require collateral or other security to support accounts receivable. At December 31, 2006 four customers accounted for 30%, 20%, 14% and 14% of total accounts receivable. At December 31, 2005 these four customers accounted for 0%, 28%, 0.2% and 59% of total accounts receivable.

The Company maintains demand deposits with financial institutions with credit risk, in the normal course of business to meet its operating needs. The Company's credit risk lies with the exposure to loss of uninsured demand deposits in the event of nonperformance by these financial institutions. The cash balances on deposit with financial institutions exceeded federally insured limits by approximately $5,879,195 and $6,300,000 at December 31, 2006 and 2005, respectively.

In 2006, 67% of the Company's purchases were made from three vendors located in Asia. These three vendors were responsible for manufacturing most of the Company's new camera inventory. In 2005 64% of the Company's purchases were made from these three vendors.

9. Commitments and Contingencies

(a) Leases

The Company leases equipment under non-cancelable capital leases. Lease terms range from three to five years. As of December 31, 2006, commitments under capital leases were as follows:

Years Ending December 31,		
2007	$	144,674
2008		104,722
Total commitment		249,396
Residual value on equipment		4,243
Amount representing interest		(29,533)
Future minimum rental payments		224,106
Less current portion		(120,138)
Long term portion	$	103,968

The Company leases office spaces under operating leases with initial or remaining non-cancelable lease terms in excess of one year. These operating lease agreements expire through February 28, 2010, with renewal options for certain operating leases of up to 3 years. The terms of the leases provide for fixed or minimum rental payments.

The required future minimum rental payments under non-cancelable operating leases as of December 31, 2006 are as follows:

Years Ending December 31,	
2007	$ 407,350
2008	183,132
2009	175,254
2010	29,415
Total	$ 795,151

Total rent expense under operating leases was $274,200 and $217,000 for the years ended December 31, 2006 and 2005 respectively.

10. Related Parties

During 2006 and 2005, the following related party (common and preferred shareholders) amounts were expensed in the statement of operations:

	2006	2005
Legal services	**$ 232,478**	$ 228,533
Camera parts	**1,885,950**	144,000

11. Retirement Plan

The Company has a 401(k) plan covering all eligible employees. Participating employees may elect to contribute up to 100% of their annual compensation, subject to annual contribution limitations set by Internal Revenue Service. Employee contributions and earnings thereon vest immediately. The Company does not match employee contributions.

12. Subsequent Events

Series F Convertible Preferred Stock:

On April 12, 2007, the Company issued 10,842,414 shares of Series F convertible preferred stock and received proceeds, net of issuance costs, totaling $38,210,214. In connection with the Series F Preferred Stock offering, the Board of Directors and stockholders of the Company approved the filing of a Restated Certificate. Effective as of the filing of the Restated Certificate on April 11, 2007, the Company:

- Increased the total number of authorized shares of common stock to 85,000,000;
- Increased the total number of authorized shares of preferred stock to 62,985,789;
- Limited shares for Series E preferred stock to 8,098,377;
- Designated 10,980,000 shares as Series F preferred stock.

Significant terms of the Series F preferred stock are as follows:

Conversion - Each share of Series F preferred stock shall be convertible, at the option of the holder thereof, at any time after the date of issuance of such share. The conversion rate is determined by dividing the original issue price of such series by the applicable conversion price of such series. The original issue price of Series F shall be $3.6989. The Series F shall automatically be converted into one share of common stock at the then effective Conversion Price applicable to such series upon closing of a firm commitment underwritten public offering of the Company. Automatic conversion shall occur upon a public offering greater than $25 million.

The conversion price is subject to adjustment for certain dilutive issuances, splits and combinations, and approval by the Board of Directors.

Dividends - When declared by the Board of Directors, the holders of Series F preferred stock shall be entitled to receive dividends at the rate per annum of $0.2219, prior and in preference to any declaration or payment of any dividend on the Series A preferred stock, Series B preferred stock, Series C preferred stock, Series D preferred stock, Series E preferred stock, Series A-1 preferred stock, or Common Stock. Dividends are not cumulative. No dividends have been declared.

Voting - The holders of the shares of common stock and Series A, Series B, Series C, Series D, Series E, Series F and Series A-1 preferred stock shall vote together as a single class on all matters, voting on an as converted basis.

Liquidation: In the event of any liquidation, dissolution or winding up of the Company (including a merger, reorganization or other transaction in which more than 50% of the outstanding voting power of the Company is transferred), the holders of the Series F preferred stock shall be entitled to receive, in preference to the holders of the Series A, Series B, Series C, Series D, Series E and Series A-1 preferred stock, an amount per share equal to the sum of (a) the original purchase price per share, plus (b) all declared but unpaid dividends on such share.

Pure Digital Technologies, Inc.

Financial Statements
Years ended December 31, 2007 and 2006

BDO

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