



BURST.COM, INC. AND SUBSIDIARIES

**Financial Statements
December 31, 2007 and 2006**

Burst.com, Inc. and Subsidiaries

Table of Contents

	<u>Page</u>
Independent Auditors' Report	1
Consolidated Balance Sheets	2
Consolidated Statements of Operations	3
Consolidated Statements of Changes in Stockholders' Equity	4
Consolidated Statements of Cash Flows	5
Notes to Consolidated Financial Statements	6-19



SMITH, LANGE & PHILLIPS LLP

Independent Auditors' Report

To the Board of Directors and Stockholders of
Burst.com, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheet of Burst.com, Inc. (a Delaware Corporation) and subsidiaries (the "Company") as of December 31, 2007, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The financial statements as of December 31, 2006 were audited by other auditors whose report dated February 22, 2007, expressed an unqualified opinion on those statements.

We conducted our audit 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2007, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Smith, Lange & Phillips LLP

San Francisco, California
March 24, 2008

Burst.com, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31, 2007 and 2006

Assets

	2007	2006
Current assets		
Cash and cash equivalents	\$ 5,820,538	\$ 653,026
Investments in Treasury bills	706,070	2,837,175
Prepaid expenses and advances	19,461	12,200
Income tax receivable	58,381	-
	6,604,450	3,502,401
 Property and equipment, net	 -	 -
 Other assets		
Investments in Treasury notes	717,937	-
Other assets	8,740	2,740
	726,677	2,740
	\$ 7,331,127	\$ 3,505,141

Liabilities

Current liabilities

Accrued expenses and accounts payable	\$ 95,707	\$ 49,921
---------------------------------------	-----------	-----------

Stockholders' equity

Convertible preferred stock, \$.00001 par value; 20,000,000 shares authorized; none issued and outstanding	-	-
Common stock, \$.00001 par value; 100,000,000 shares authorized; 38,250,480 and 39,950,633 shares issued and outstanding, respectively	400	400
Additional paid-in-capital	67,908,552	68,008,864
Accumulated deficit	(59,260,124)	(62,698,508)
Stockholders' notes receivable, including accrued interest of \$173,482 and \$109,951, respectively	(1,438,022)	(1,850,534)
Accumulated other comprehensive income: Unrealized gain (loss) on marketable securities	24,614	(5,002)
	7,235,420	3,455,220
	\$ 7,331,127	\$ 3,505,141

See auditors' report and accompanying notes.

Burst.com Inc. and Subsidiaries

Consolidated Statements of Operations

Years Ended December 31, 2007 and 2006

	2007	2006
Revenue	\$ 10,000,000	\$ -
Costs and expenses:		
General and administrative	1,223,528	762,965
Legal fees and costs associated with licensing revenue	5,368,267	-
	<u>6,591,795</u>	<u>762,965</u>
Income (loss) from operations	3,408,205	(762,965)
Other income (expenses):		
Interest income	184,826	174,054
Interest expense	(9,285)	(3,123)
Gain on sale of securities	51,278	59,675
Other taxes	(2,899)	-
	<u>223,920</u>	<u>230,606</u>
Income (loss) before income taxes	3,632,125	(532,359)
Income taxes	193,741	850
Net income (loss)	<u>3,438,384</u>	<u>(533,209)</u>
Unrealized gain (loss)	<u>29,616</u>	<u>(35,892)</u>
Total comprehensive income (loss)	\$ <u>3,468,000</u>	\$ <u>(569,101)</u>
Net income (loss) per share, basic	\$ <u>0.0871</u>	\$ <u>(0.01)</u>
Net income per share, diluted	\$ <u>0.0868</u>	\$ <u>-</u>
Weighted average number of common shares outstanding	<u>39,894,738</u>	<u>35,391,968</u>

See auditors' report and accompanying notes.

Burst.com, Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2007 and 2006

	Common Stock	Amount	Shareholders' Notes	Accumulated Other Comprehensive Income	Additional Paid-In Capital	Deficit	Total
Balance, December 31, 2005	39,950,633	\$ 400	\$ (1,804,790)	\$ 30,890	\$ 68,008,864	\$ (62,165,299)	\$ 4,070,065
Net loss	-	-	-	-	-	(533,209)	(533,209)
Unrealized loss on securities	-	-	-	(35,892)	-	-	(35,892)
Interest earned on shareholders' notes	-	-	(45,744)	-	-	-	(45,744)
Balance, December 31, 2006	39,950,633	400	(1,850,534)	(5,002)	68,008,864	(62,698,508)	3,455,220
Repurchase of stock, \$.28 per share	(1,700,153)		476,043	-	(476,043)	-	-
Warrants granted	-	-	-	-	375,731	-	375,731
Net income	-	-	-	-	-	3,438,384	3,438,384
Unrealized gain on securities	-	-	-	29,616	-	-	29,616
Interest earned on shareholders' notes	-	-	(63,531)	-	-	-	(63,531)
Balance, December 31, 2007	<u>38,250,480</u>	<u>\$ 400</u>	<u>\$ (1,438,022)</u>	<u>\$ 24,614</u>	<u>\$ 67,908,552</u>	<u>\$ (59,260,124)</u>	<u>\$ 7,235,420</u>

See auditors' report and accompanying notes.

Burst.com, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2007 and 2006

	2007	2006
Cash flows from operating activities:		
Net income (loss)	\$ 3,438,384	\$ (533,209)
Adjustments to reconcile net income (loss) to net cash used by operating activities:		
Depreciation and amortization	5,669	2,300
Increase in comprehensive income	29,616	-
Grant of warrants	375,731	-
Realized gain on securities	(51,278)	-
(Increase) decrease in assets:		
Prepaid expenses and advances	(7,260)	(12,200)
Interest receivable on shareholders' notes	(63,531)	(45,744)
Income tax receivable	(58,381)	-
Other current assets	(6,000)	5,376
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	45,784	(2,742)
State income taxes payable	-	(1,448,909)
Net cash provided (used) by operating activities	3,708,734	(2,035,128)
Cash flows from investing activities:		
Purchase of securities available-for-sale	(1,235,553)	(2,246,817)
Proceeds from sale of securities available-for-sale	2,700,000	4,857,666
Purchase of equipment	(5,669)	(2,300)
Net cash provided by investing activities	1,458,778	2,608,549
Net increase in cash and cash equivalents	5,167,512	573,421
Cash and cash equivalents, beginning of year	653,026	79,605
Cash and cash equivalents, end of year	\$ 5,820,538	\$ 653,026
Supplemental disclosures:		
Cash paid for income taxes	\$ 193,741	\$ 800
Cash paid for interest	\$ 9,285	\$ 3,123
Non-cash transactions:		
Repurchase of stock applied to stockholders' notes	\$ 476,043	\$ -

See auditors' report and accompanying notes.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 1 - Description of Business and Summary of Significant Accounting Policies

Organization and capitalization - Burst.com, Inc. and subsidiaries (collectively, unless the context otherwise requires, the "Company") was incorporated in the State of Delaware as Instant Video Technologies, Inc. On January 27, 2000, the Certificate of Incorporation was amended to change the Company's name to Burst.com, Inc.

The Company's authorized capital stock consists of 100,000,000 shares of common stock, \$0.00001 par value per share, and 20,000,000 shares of preferred stock, \$0.00001 per share.

The board of directors has the authority, without action by the Company's stockholders, to provide for the issuance of preferred stock in one or more classes or series and to designate the rights, preferences and privileges of each class or series, which may be greater than the rights of the common stock. The Company had no preferred stock outstanding as of December 31, 2007 and 2006.

Business - The Company licenses burst transmission technology and other intellectual property for use within commercial, multimedia and interactive environments. The burst technology allows for burst transmission of video/audio programming that results in time-savings, network efficiency and superior quality production.

Principles of consolidation - The consolidated financial statements include the accounts of Burst.com, Inc and its wholly-owned subsidiaries, Explore Technology, Inc. and Timeshift-TV. All significant intercompany balances and transactions have been eliminated. For the years ended December 31, 2007 and 2006, the subsidiaries were inactive.

Use of estimates - The accompanying consolidated financial statements have been prepared in conformity with U.S generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and operations for the period. Although these estimates are based on management's knowledge of current events and actions it may undertake in the future, they may ultimately differ from actual results. The Company's most significant estimates are those related to the valuation of stock, stock options, and warrants in connection with equity and financing transactions.

Cash and cash equivalents - Cash and cash equivalents consist of money market accounts and other short-term investments with an original maturity of three months or less.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

Concentration of credit risk - Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash. The Company maintains cash balances at several banks. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000. From time to time, the Company had cash in financial institutions in excess of federally insured limits.

Investments - In accordance with the Financial Accounting Standards Board Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ("SFAS No. 115"), securities are classified into three categories: held-to-maturity, available-for-sale and trading. The Company's investments consisted of debt securities classified as available-for-sale. Accordingly, they were carried at fair value in accordance with SFAS No. 115. Further, SFAS No. 115 requires that unrealized gains and losses for available-for-sale securities be excluded from earnings and reported, net of deferred income taxes, as other comprehensive income.

Comprehensive income - Financial Accounting Standards Board Statement No. 130, *Reporting Comprehensive Income* ("SFAS 130"), requires the reporting of comprehensive income in addition to net income from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosures of certain financial information that historically has not been recognized in the calculation of net income. For the year ended December 31, 2007 and 2006, the Company's comprehensive income consists of unrealized gains and losses on securities available for sale, net of the related estimated deferred income tax effect associated with those gains and losses.

Revenue recognition - License fees are generally recognized as revenue ratably over the license period. Revenue from settlements is recognized when received. The revenue from settlements is reported gross of legal fees and costs in accordance with the Emerging Issues Task Force No. 99-19, *Reporting Revenue Gross as a Principal or Net as an Agent* (EITF 99-19").

Property, equipment and depreciation - Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets that range from three to five years. Replacements, maintenance and repairs, which do not extend the lives of the respective assets are charged to expense as incurred.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

Fair value of financial instruments - The Company's financial instruments consist primarily of cash and cash equivalents, available-for-sale securities, accounts receivable, and accounts payable. The carrying amounts of such financial instruments approximate their respective estimated fair value due to the short-term maturities and approximate market interest rates of these instruments.

Net income (loss) per common share and dilutive securities - Earnings (loss) per share is computed in accordance with the Financial Accounting Standards Board Statement No. 128, *Earnings per Share* ("SFAS 128"). Basic earnings per share is computed by dividing net income, after deducting preferred stock dividends accumulated during the period, if any, by the weighted-average number of shares of common stock outstanding during each period. Diluted earnings per share is computed by dividing net income by the weighted-average number of shares of common stock, common stock equivalents, and other potentially dilutive securities outstanding during the period.

As of December 31, 2006, the following is a summary of the securities that could potentially dilute basic loss per share in the future that were not included in the computation of diluted loss per share because to do so would be anti-dilutive.

	<u>December 31, 2006</u>
Options	673,100
Warrants	<u>211,818</u>
Total	<u><u>884,918</u></u>

For the year ended December 31, 2007, only 145,817 securities out of a total 1,355,434 securities were incremental shares and were included in the calculation of diluted earnings per share.

Income taxes - The Company records its income tax liability in accordance with Financial Accounting Standards Board Statement 109, *Accounting for Income Taxes* ("SFAS 109"). Under the provisions of SFAS 109, an entity recognizes deferred tax assets and liabilities for future tax consequences of events that have been previously recognized in the Company's financial statements or tax returns. The measurement of deferred tax assets and liabilities is based on provisions on the enacted tax law; the effects of future changes in tax laws or rates are not anticipated.

Advertising costs - Advertising costs are expensed as incurred. For the years ended December 31, 2007 and 2006, there were no advertising costs.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

Research and development - Research and development costs are charged to operations as incurred until such time as both technological feasibility is established and future economic benefit is assured. To date, such conditions have not been satisfied, and, accordingly, all software engineering and development costs have been expensed as incurred.

Patent expenses - The Company charges the costs of internally developing patents to expense as they are incurred, in accordance with the Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142").

Stock-based compensation - In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* ("SFAS No. 123(R)"). SFAS No. 123(R) requires all share-based payments to employees (or to non-employee directors as compensation for service on the Board of Directors) to be recognized as compensation expense in the consolidated financial statements, based on the fair values of such payments.

The Company adopted SFAS No. 123(R) on January 1, 2006 using the modified prospective transition method. Under this method, compensation cost recognized on the consolidated statement of operations includes (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("SFAS No. 123"), and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The results for prior periods have not been restated. As of January 1, 2006, all the options were vested. For the year ended December 31, 2006, no options were granted or vested; subsequently, no compensation expense was recorded.

Prior to January 1, 2006, the Company applied the intrinsic value-based method of accounting prescribed by the Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, including Financial Accounting Standards Board Interpretation 44, *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25*, and related interpretations and has adopted the disclosure only provisions of SFAS No. 123. Under this method, compensation expense was recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Prior to January 1, 2006, the Company provided pro forma disclosure amounts in accordance with SFAS No. 123, as amended by

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure* (“SFAS No. 148”).

The Company estimates the value of the options granted to employees using the Black-Scholes model. The expected term represents the period of time that options granted are expected to be outstanding, which is usually the time until the option expires. The risk-free interest rate for each option is based on the Treasury bill yield in effect at the date of each grant assuming the expected term to maturity.

For the year ended December 31, 2007, 600,000 warrants were granted to the Company’s employees and board members. Consequently, approximately \$376,000 of stock options compensation expense was recorded. The assumptions used in the calculation of the fair value of the warrants granted in 2007, using the Black-Scholes model, were as follows:

Weighted average exercise price	\$1.56
Weighted average expected term (in years)	5
Expected volatility	10.3%
Weighted average risk-free interest rate	4.8%

Stock-based compensation arrangements to nonemployees are accounted for in accordance with SFAS No. 123, as amended by SFAS No. 148, and Emerging Issues Task Force No. 96-18, *Accounting for Equity Instruments that Are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (“EITF No. 96-18”), using a fair value approach. The compensation costs of these arrangements are booked as consulting expense. Awards granted to directors appointed by employer’s shareholders for their services as directors will be treated as awards to employees. Awards granted to directors for other services are accounted for as awards to nonemployees. For the year ended December 31, 2006, no options were granted to nonemployees. Consequently, no stock options consulting expense was calculated or recorded in 2006. During the year ended December 31, 2007, 300,000 out of 600,000 total warrants granted were issued to board members. These awards were treated as awards for services rendered as directors and were therefore recorded as awards to employees.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 1 - Description of Business and Summary of Significant Accounting Policies (continued)

Reclassifications and corrections - Certain items have been reclassified to conform to correct presentation as follows. In the balance sheet as of December 31, 2006, which was audited by other auditors with the auditor's report dated February 7, 2007, money market funds of \$483,708 were included in investments in securities account. These funds were reclassified to cash and cash equivalents to conform to correct presentation. Also, in the balance sheet as of December 31, 2006, which was audited by other auditors with the auditor's report dated February 7, 2007, notes receivable from shareholders, which represented stock subscriptions receivable from stock option exercises, were presented in the assets section of the balance sheet. These shareholders' notes receivable of \$1,850,534, in total, including accrued interest of \$109,951, were reclassified and presented as a deduction of stockholders' equity to conform to correct presentation.

Note 2 - Investments in Securities Available-For-Sale

Investments consist exclusively of US Treasury bills and notes. As of December 31, 2007, the aggregate market value of investments exceeded their aggregate cost by \$24,614. As of December 31, 2006, the aggregate market value of investments was lower than their aggregate cost by \$5,002. As of December 31, 2006 all the investments in US Treasury bills had a maturity date within one year from the balance sheet date.

As of December 31, 2007, investments consisted of the following:

	<u>Cost</u>	<u>Gross Unrealized Gain</u>	<u>Gross Unrealized Loss</u>	<u>Fair Market Value</u>
US Treasury bills, due within one year	\$ 700,696	\$ 5,374	\$ -	\$ 706,070
			-	
US Treasury notes, due from one to five years	<u>698,697</u>	<u>19,240</u>	<u>-</u>	<u>717,937</u>
	<u>\$ 1,399,393</u>	<u>\$ 24,614</u>	<u>\$ -</u>	<u>\$ 1,424,007</u>

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 3 - Property and Equipment

As of December 31, 2007 and 2006, property and equipment consisted of the following:

	<u>2007</u>	<u>2006</u>
Computer equipment	\$ 65,612	\$ 65,612
Furniture	20,669	15,000
Office equipment	5,000	5,000
Software	55,644	55,644
Trade show booth	<u>5,000</u>	<u>5,000</u>
	151,925	146,256
Less accumulated depreciation	<u>(151,925)</u>	<u>(146,256)</u>
	\$ <u>-</u>	\$ <u>-</u>

For the years ended December 31, 2007 and 2006, depreciation expense was \$5,669 and \$2,300, respectively.

Note 4 - Notes Receivable - Shareholders

Stock subscriptions receivable that resulted from stock option exercises are reported as a deduction from stockholders' equity. As of December 31, 2007 and 2006, notes receivable-shareholders consisted of the following:

	<u>2007</u>	<u>2006</u>
Note receivable from employee bears interest at 3.65% and 2.5%, respectively, per annum; secured by 500,000 shares of stock in the Company; due September 22, 2012.	\$ 376,982	\$ 839,475
Note receivable from employee bears interest at 3.65% and 2.5%, respectively, per annum; secured by 156,975 shares of stock in the Company; due September 20, 2012.	112,558	126,108
Note receivable from employee, bears interest at 3.65% and 2.5%, respectively, per annum; secured by 1,250,000 shares of stock in the company; due to April 18, 2014.	625,000	625,000

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 4 - Notes Receivable - Shareholders (continued)

Note receivable from employee bears interest at 3.65% and 2.5%, respectively, per annum; secured by 250,000 shares of company stock; due April 18, 2014.	125,000	125,000
Note receivable from employee bears interest at 3.65% and 2.5%, respectively, per annum; secured by 50,000 shares of company stock; due April 18, 2014.	<u>25,000</u>	<u>25,000</u>
	1,264,540	1,740,583
Accrued interest on notes receivable	<u>173,482</u>	<u>109,951</u>
	<u>\$ 1,438,022</u>	<u>\$ 1,850,534</u>

During 2003, Richard Lang and Eric Walters exercised all their vested options totaling 2,151,761 and 198,392 shares, respectively. As part of this transaction, the Company officers executed notes payable to the Company for \$839,475 and \$126,107, respectively. The shares served as collateral on the notes. On December 20, 2007, the Company reformed the notes from being non-recourse to full re-course. In addition, the Company repurchased 1,651,761 shares of common stock from Richard Lang and reduced the principal amount of his note by \$462,293. The Company also repurchased 48,392 shares of common stock from Eric Walters and reduced the principal amount of his note by \$13,550. The shares were tendered at the December 20, 2007 share price of \$.28 per share.

During 2005, Richard Lang, Eric Walters and Colt Briner exercised all their vested options totaling 1,250,000, 250,000 and 50,000 shares, respectively. As part of this transaction, the Company officers and employees executed non-recourse notes payable to the Company for \$625,000, \$125,000 and \$25,000, respectively. The shares are collateral on the notes.

Note 5 - Stock Options

The Company has two stock incentive plans. Under the 1998 Stock Option Plan ("the 1998 Plan"), the maximum aggregate number of shares which may be subject to option and sold under the 1998 Plan is 3,200,000.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 5 - Stock Options (continued)

Under the 1998 Plan, the option shall be designated as either the incentive stock option or non-qualified stock option. Awards other than incentive stock options may be granted to employees, directors, and consultants. Incentive stock options may be granted to employees of the Company. The term of each award shall be the term stated in the award agreement, provided however, that the term shall be no more than ten years from the date of grant. However, if an incentive stock option is granted to a grantee who, at the time of the option is granted, owns stock representing more than 10% percent of the voting power of all classes of stock of the Company, then the term of the incentive stock option shall be five years from the date of grant. The exercise or purchase price, for an award shall be as follows: (i) if an incentive stock options is (A) granted to an employee who, at the time of the grant of such incentive stock option owns stock representing more than 10% of the voting power of all classes of stock of the Company, then the per share exercise price shall be less than 110% of the fair market value per share on the date of grant, (B) granted to any other employee, then the per share exercise price shall be less than 100% of the fair market value per share on the date of grant. (ii) If a non-qualified stock option is, (A) granted to a person who, at the time of the grant of such option, owns stock representing more than 10% of the voting power of all classes of stock of the Company, then the per share exercise price shall be less than 110% of the fair market value per share on the date of the grant, (B) granted to any other person, then the per share exercise price shall be less than 85% of the fair market value per share of the date of the grant.

Under the 1999 Stock Option Plan ("the 1999 Plan"), the maximum aggregate number of shares which may be subject to option and sold under the 1999 Plan is 3,000,000. Non-qualified stock options may be granted to employees, directors and consultants. Incentive stock options may be granted only to employees. The board of directors determines the provisions, terms and conditions of each option, including vesting schedule (which in no case shall be less than 20% per year over five years from the date of grant), repurchase provisions, forfeiture provisions, etc. The maximum number of shares with respect to which options may be granted shall be 300,000. The term of each option shall be the term stated in the option agreement, provided, however, that the term of the incentive stock option shall be no more than ten years from the date of grant. If an incentive option is granted to an optionee who owns more than 10% of the voting power of all classes of stock, (i) the term of the option shall be five years from the date of the grant and (ii) the per share exercise price shall be no less than 110% of the fair market value per share on the date of grant. If an incentive stock option is granted to any employee other than described above, the per share exercise price shall not be less than 100% of the fair market value per share on the date of the grant. If a non-qualified stock option is granted to a person who at that time of the grant owns stock representing more than 10% of the voting power of all classes of the

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 5 - Stock Options (continued)

Company's stock, then the per share exercise price shall be no less than 110% of the fair market value per share on the date of grant. If a non-qualified stock option is granted to any other person, then the per share exercise price shall be no less than 85% of the fair market value per share at the date of the grant. The following is a summary of all option and warrants activity for the years ended December 31, 2007 and 2006.

	<u>Options Outstanding</u>		<u>Warrants Outstanding</u>	
	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Number of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance on December 31, 2005	675,600	\$ 1.29	211,818	\$ 2.71
Option/warrants expired	(2,500)		<u>0</u>	
Balance, December 31, 2006	673,100	\$ 1.48	211,818	\$ 2.71
Option/warrants expired	(1,000)	\$ 1.00	(128,484)	\$ 3.50
Warrants granted	<u>-</u>		<u>600,000</u>	\$ 1.56
Balance, December 31, 2007	<u>672,100</u>	\$ 1.48	<u>683,334</u>	\$ 1.55

As of December 31, 2007, there were 2,341,980 shares available for grant as options under the 1998 Plan. As of December 31, 2007, there were 1,612,983 shares available for grant as options under the 1999 Plan. All options granted since the 2002 year, were not under the Plans. Rather, they were non-qualified stock options authorized individually by the board of directors.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 5 - Stock Options (continued)

As of December 31, 2007, stock options and warrants exercisable were as follows:

Options:

Exercise Price Per Share	Options Granted	Options Outstanding			Options Exercisable	
		Number Outstanding	Weighted Average Exercise Price	Weighted Average Contractual Remaining Life (Years)	Number Exercisable	Weighted Average Exercise Price
\$0.50-\$0.99	400,000	400,000	\$ 0.50	0.38	400,000	\$ 0.50
\$1.00-\$1.50	12,100	12,100	\$ 1.44	0.30	12,100	\$ 1.44
\$2.50	200,000	200,000	\$ 2.50	2.57	200,000	\$ 2.50
\$4.63	60,000	60,000	\$ 4.63	2.74	600,000	\$ 4.63
	<u>672,100</u>	<u>672,100</u>	<u>\$ 1.48</u>	<u>1.24</u>	<u>672,100</u>	<u>\$ 1.48</u>

For the year ended December 31, 2007, no options were granted. All the options previously granted were fully vested at the date of the grant.

Warrants:

Exercise Price per Share	Warrants Granted	Warrants Outstanding			Warrants Exercisable	
		Number Outstanding	Weighted Average Exercise Price	Weighted Average Contractual Remaining Life (Years)	Number Exercisable	Weighted Average Exercise Price
\$1.50	83,334	83,334	\$ 1.50	1.78	83,334	\$ 1.50
\$1.56	600,000	600,000	\$ 1.56	4.39	600,000	\$ 1.56
	<u>683,334</u>	<u>683,334</u>	<u>\$ 1.55</u>	<u>4.08</u>	<u>683,334</u>	<u>\$ 1.55</u>

For the year ended December 31, 2007, 600,000 warrants were granted and were vested immediately. All warrants previously granted were fully vested at the date of the grant.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 6 - Lease Commitments

Prior to June 2007, the Company leased its office space under a one-year operating lease, which provided for one-year extensions. On June 1, 2007, the Company executed a new office lease, which provides for an eighteen month term. For the years ended December 31, 2007 and 2006, rent expense was \$26,251 and \$16,054, respectively.

Note 7 - Income Taxes

For the years ended December 31, 2007 and 2006, the provisions for federal and state income taxes are as follows:

	<u>2007</u>	<u>2006</u>
Current	\$ 193,741	\$ -
Deferred	<u>-</u>	<u>-</u>
	<u>\$ 193,741</u>	<u>\$ -</u>

As of December 31, 2007 and 2006, the Company had net operating loss carry-forwards for federal income tax purposes of approximately \$12,000,000 and \$16,000,000, respectively, subject to annual limitations, and are available to offset future taxable income, if any, through 2022.

As of December 31, 2006, net operating loss carry-forwards for state income tax purposes were approximately \$2,770,000. The net operating loss carry-forwards were fully utilized in 2007.

As of December 31, 2007 and 2006, deferred tax assets were comprised of the following:

	<u>2007</u>	<u>2006</u>
Deferred tax assets:		
Net operating losses	\$ 4,084,079	\$ 5,692,211
Research and experimentation credit	421,900	421,900
State income tax effect	37,476	398,314
Stock option compensation expense	160,964	
Other	<u>2,418</u>	<u>-</u>
Total deferred tax assets	4,706,837	6,512,425
Less: valuation allowance	(<u>4,706,837</u>)	(<u>6,512,425</u>)
	<u>\$ -</u>	<u>\$ -</u>

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 7 - Income Taxes (continued)

In assessing the amount of deferred tax assets to be recognized, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. It is not possible at this time to determine that the deferred tax assets are more likely to be realized than not. Accordingly, a full valuation allowance has been established for all years presented.

For the year ended December 31, 2007, the reconciliation between the federal statutory income tax rate and the Company's effective tax rate was as follows:

	<u>2007</u>
Income tax provision at federal statutory rates	\$ 1,235,866
Net operating loss	(1,343,278)
Current state income taxes, net of federal benefits	212,075
Permanent differences	5,563
Other	<u>83,515</u>
	<u>\$ 193,741</u>

Note 8 - Business Risks and Segment Disclosures

The Company's primary source of revenue is the licensing of its proprietary technology, and its success is largely dependent on this licensing effort. Changes in desirability of this technology in the marketplace may significantly affect the Company's future operating results.

The Company operates in one segment and, accordingly, has provided only the required enterprise-wide disclosure. For the years ended December 31, 2007 and 2006, the Company had no foreign revenues in 2007 and 2006.

Note 9 - Contingencies

During the years ended December 31, 2007 and 2006, the Company was involved in a single litigation matter. That case was settled and was dismissed on December 5, 2007.

Burst.com, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Note 10 - Revenue from Licensing Agreement

During 2007, the Company entered into a settlement agreement with a major electronics company. This settlement agreement provided the electronics company with a non-exclusive license in exchange for a one-time payment to the Company of \$10,000,000. Legal fees and costs associated with this settlement totaled \$5,368,267 (equal to 35% of gross settlement of \$3,500,000 plus \$1,868,267 of additional costs associated with the lawsuit).

Note 11 - Subsequent Events

On January 28, 2008, the Company sold 1,200,000 shares of stock to certain members of the Company's Board of Directors. The shares are subject to a non-lapse restriction in the nature of substantially discounted right of first refusal. The shares sold are burdened with a perpetual right of first refusal pursuant to which the purchasers are required to first offer the shares to the Company for a period of five business days at a discount of \$.34 from whatever price a third party offers before they can be sold to that third party. The purchase price for the stock burdened with that right of first refusal was \$.07, payable 20% in cash and 80% by execution and delivery of a non-recourse promissory note due in eight years and eleven months.