

SIERRA WIRELESS INC  
Form 6-K  
November 10, 2004

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 6-K

Report of Foreign issuer

Pursuant to Rule 13a-16 or 15d-16 of the  
Securities Exchange Act of 1934

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For the Month of November 2004

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(Commission File. No 0-30718).

## SIERRA WIRELESS, INC., A CANADA CORPORATION

(Translation of registrant's name in English)

13811 Wireless Way

Richmond, British Columbia, Canada V6V 3A4

(Address of principal executive offices and zip code)

Registrant's Telephone Number, including area code: 604-231-1100

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Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F:

Form 20-F  40-F

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes:  No:

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Sierra Wireless, Inc.

By: /s/ David G. McLennan  
David G. McLennan, Chief Financial Officer and Secretary

Date: November 10, 2004

**SIERRA WIRELESS, INC.**



**THIRD QUARTER REPORT**

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004**





**SIERRA WIRELESS, INC.**

**CHAIRMAN S MESSAGE**

**TO OUR SHAREHOLDERS**

We continued to set new records in the third quarter of 2004, generating revenue of \$59.1 million, net earnings of \$7.1 million and positive cash flow from operations. These results exceeded our expectations, and represent our ninth consecutive quarter of profitable growth and positive cash flow.

**Results for Q3 2004 Compared to Q3 2003**

For the three months ended September 30, 2004, our revenue climbed 125% to \$59.1 million, from \$26.3 million in the third quarter of 2003. The revenue increase reflects strong sales of our PC cards and embedded modules, particularly in North American markets.

Gross margin percentage decreased slightly to 39.0% of revenue, from 40.7% of revenue in the comparable quarter as a result of changes in product mix and new product introduction costs. Third quarter operating expenses were \$15.4 million, compared to \$11.5 million for the same period in 2003. The increase in operating expenses reflects additional costs to generate increased revenues, product and market development costs, including costs for the AirCard 775® for EDGE networks and the Voq Professional Phone™, and an additional facilities charge which was comprised mainly of a foreign exchange adjustment.

Net earnings for the third quarter of 2004 increased to \$7.1 million, or diluted earnings per share of \$0.27, from a net loss of \$0.9 million, or loss per share of \$0.05, in the third quarter of 2003. Excluding the restructuring and integration costs and Metricom recovery, net earnings for the third quarter of 2003 were \$1.1 million, or diluted earnings per share of \$0.06.

**Q3 2004 Results Compared to Guidance**

Third quarter revenue of \$59.1 million exceeded our guidance of approximately \$57.0 million. Gross margin of 39% was within our guidance range of 39% to 40%. Operating expenses were \$15.4 million, or 26% of revenue, higher than our guidance of approximately \$14.8 million, or 26% of revenue. Net earnings of \$7.1 million, or diluted earnings per share of \$0.27, exceeded our guidance of net earnings of approximately \$6.4 million, or diluted earnings per share of \$0.24, while our cash flow from operations was \$8.0 million, consistent with our guidance of positive cash flow.

**Business Developments**

The third quarter included a number of business and corporate developments:

Progress on Products for CDMA 2000 Networks and Channels:

We announced a distribution agreement with Premier Wireless Solutions for our embedded CDMA modules. Under the agreement, Premier Wireless, a distributor of wireless machine-to-machine fixed and mobile communications services and products, will distribute and offer integration support for the Sierra Wireless EM3420 embedded module.

We announced an agreement with Tirumala Seven Hills Pvt Ltd. ( TSH ), a telecommunications company in India, to distribute the award winning AirCard 555 wide area wireless network card to the India marketplace. We expect to commence commercial shipments of the AirCard 555 to TSH in the fourth quarter of 2004.

We announced that we are supplying Sierra Wireless EM3420 embedded modules to Symbol Technologies, Inc. for its MC9000 family of industrial mobile computing devices. Symbol's rugged handheld computers scan, send, and retrieve data wirelessly, moving information from the factory, to the warehouse, to the sales floor, and to the point of business activity, in industries ranging from manufacturing and retail, to logistics and transportation.

The Treo 600 Smartphone by palmOne, featuring an integrated Sierra Wireless EM3420 embedded module, was certified by and became available from Verizon Wireless.

Progress on Products for GSM/GPRS/EDGE Networks and Channels:

We signed an agreement with Onda Communication Spa to distribute our first EDGE product, the ONDA EDGE/GPRS N775 PC Card, for use on the Telecom Italia Mobile GSM, GPRS and EDGE Network. The commercial launch marks the worldwide premiere of Sierra Wireless EDGE product line.

We announced an agreement with Intel to deliver integrated wireless connectivity solutions to mobile professionals worldwide beginning in early 2005. The solution combines the new Intel® Centrino mobile technology-based notebook WLAN and a Sierra Wireless AirCard 775 EDGE PC Card for WWAN, together with wireless data services from a local carrier. Customers purchasing the solution will be able to use their notebook computers to access and manage wireless connections through a single software interface and a single account for billing.

Subsequent to the end of the third quarter, we announced that the AirCard 775 wireless wide area network card for EDGE networks is now available on the AT&T Wireless EDGE network for \$299.99. Customers who sign up for unlimited data rate plans are eligible for a \$150 rebate. The AirCard 775 provides mobile users with data rates up to three times faster than on GPRS networks, delivering fast, wireless connectivity to the Internet, e-mail, and corporate applications.

Progress on the Voq Professional Phone:

Together with KPN, we announced a global first with the commercial availability of our Voq Professional Phone throughout the Netherlands. The Voq Professional Phone is a Microsoft Windows Mobile-based Smartphone. KPN is distributing the Voq via its distribution channels at a retail price of 99 in combination with a two-year Business Select subscription and a 5Mb GPRS data package.

We extended commercial availability of the Voq Professional Phone across Europe with a number of key distribution partners. The Voq is now available for purchase from A & C Systems in Belgium, Luxemburg, and The Netherlands; from BagLAN in Turkey; from Cedros in Austria, Germany, and Switzerland; from Daimler in the Nordics; from Dangaard Telecom in Western Europe; from Hugh Symons Mobile Computing and Yes Telecom in the United Kingdom; from Speeka in Italy; and from Xacom Comunicaciones in France and Spain.

In September, the Voq Professional Phone became available through members of Intel's Product Dealer program, including TigerDirect, Tech Depot and CellStar Corporation. Intel Product Dealers are active resellers of Intel products, with access to marketing resources, enhanced technical support, and superior training options offered by Intel.

We extended availability of the Voq Professional Phone through Insight, MobilePlanet, and RCS Computer Experience. The Voq is available at select reseller locations and online, for the end-user price of US \$499, with activation on the AT&T Wireless network.

We announced distribution agreements with Brightpoint and Cellstar to distribute the Voq Professional Phone in the North American market. In addition, we announced network approval for the Voq on the AT&T Wireless GSM/GPRS network.

Corporate Developments:

We announced a number of management changes, including the appointment of Jason W. Cohenour to Chief Operating Officer, Jim Kirkpatrick to Chief Technical Officer and Bill Dodson to Senior Vice-President, Operations. We also reported the resignation of Senior Vice-President, Marketing, Andrew S. G. Harries, who has left the company to pursue a new business opportunity.

**Outlook**

We anticipate strong operating results in the fourth quarter of 2004, with continued growth in our revenue and earnings. We expect to make significant CDMA module shipments to palmOne for the Treo 600 during the fourth quarter. By year-end we expect to have completed the shipment of orders on hand and currently do not have visibility on further shipments for this product with palmOne.

We continue to invest in new products, including products for EVDO, EDGE and UMTS networks, and to invest in expanding distribution and sell through for our products, including the Voq Professional Phone. These investments are motivated by our goals of continued industry leadership and profitable growth.

/s/ David B. Sutcliffe

David B. Sutcliffe

Chairman and Chief Executive Officer

This report contains forward-looking statements that involve risks and uncertainties. These forward-looking statements relate to, among other things, plans and timing for the introduction or enhancement of our services and products, statements about future market conditions, supply and demand conditions, and other expectations, intentions and plans contained in this report that are not historical fact. Our expectations regarding future revenues and earnings depend upon our ability to develop, manufacture, supply and market products that we do not produce today and that meet defined specifications. When used in this report, the words plan, expect, believe, and similar expressions generally identify forward-looking statements. These statements reflect our current expectations. They are subject to a number of risks and uncertainties, including, but not limited to, changes in technology and changes in the wireless communications market. In light of the many risks and uncertainties surrounding the wireless communications market, you should understand that we cannot assure you that the forward-looking statements contained in this report will be realized.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion of our consolidated financial condition and results of operations, as of November 1, 2004, has been prepared in accordance with United States generally accepted accounting principles (GAAP) and, except where otherwise specifically indicated, all amounts are expressed in United States dollars.*

*Additional information related to Sierra Wireless, Inc., including our Annual Information Form, may be found on SEDAR at [www.sedar.com](http://www.sedar.com).*

**Overview**

We provide highly differentiated wireless solutions worldwide. We develop and market a broad range of products that include wireless data modems for portable computers, embedded modules for original equipment manufacturers, or OEMs, rugged vehicle-mounted modems and mobile phones. Our products permit users to access wireless data and voice networks using notebook computers, personal digital assistants, or PDAs, vehicle-based systems and mobile phones.

Wireless data communications is an expanding market positioned at the convergence of wireless communications, portable computing and the Internet, each of which we believe represents a growing market. Our products are based on open standards, including the Internet protocol, and operate on the networks of major wireless communications service providers.

Our products are primarily used by businesses and government organizations to enable their employees access to a wide range of wireless data applications including Internet access, e-mail, messaging, corporate intranet access, remote database inquiry and computer aided dispatch. We sell our products through indirect channels, including wireless operators, resellers and OEMs.

Beginning in fiscal 2001, there was a slowdown in enterprise spending and an overall economic slowdown that impacted our business. The trend intensified during fiscal 2002 and continued into fiscal 2003. Reasons for the market deterioration included a general economic slowdown, customer bankruptcies, network build-out delays and limited availability of capital. During the latter part of 2003 and the first nine months of 2004, we experienced stronger than expected demand.

During the third quarter of 2004, our revenue increased 125.3% to \$59.1 million, compared to \$26.3 million in the third quarter of 2003, as a result of strong revenue from our PC card and OEM products, including products formerly sold by AirPrime, Inc. ( AirPrime ). Our revenue from customers in the Americas, Europe and the Asia-Pacific region comprised 91%, 5% and 4%, respectively, of our total revenue in the third quarter of 2004 and 81%, 15% and 4%, respectively, in the same period of 2003. Our North American business has increased significantly compared to the prior year as a result of strong sales of our PC card and OEM products to North American customers. Our North American business continues to be dominated by near term demand from channels rather than by long-term, large volume commitments. In Europe, deployments of EDGE and UMTS networks have been gaining momentum and have negatively affected our GSM/GPRS sales in that region. We do not currently have a UMTS product. During the third quarter, we began commercial shipments of the AirCard® 775 for EDGE networks to customers in North America and Europe.

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Operating expenses were \$15.4 million in the third quarter of 2004 and increased from \$11.5 million in the prior year due to additional costs incurred in generating increased revenue, the acquisition of AirPrime in August 2003, and costs related to the development and marketing of new products, including products for EDGE networks and the Voq professional phone.

Net earnings were \$7.1 million, or diluted earnings per share of \$0.27, in the third quarter of 2004, compared to a loss of \$0.9 million, or loss per share of \$0.05, in the same period of 2003. Our improvement in net earnings was attributable to an increase in revenue, strong margins, operating cost control and a reduction in restructuring and integration costs that were related to the acquisition of AirPrime.

Our balance sheet remains strong, with \$127.5 million of cash and short and long-term investments, compared to \$109.7 million at December 31, 2003. During the third quarter of 2004, we generated \$8.0 million in cash from operations, compared to \$4.1 million in the same period of 2003.

**Results of Operations**

The following table sets forth our operating results for the three and nine months ended September 30, 2004, expressed as a percentage of revenue:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	61.0	59.3	60.1	59.9
Gross margin	39.0	40.7	39.9	40.1
Expenses				
Sales and marketing	9.5	10.1	9.3	11.9
Research and development, net	11.1	17.8	11.3	15.5
Administration	4.0	5.1	4.6	6.5
Restructuring and other charges	0.5	4.7	0.2	1.8
Integration costs		3.9		1.5
Amortization	1.0	2.2	1.2	2.5
	26.1	43.8	26.6	39.7
Earnings (loss) from operations	12.9	(3.1)	13.3	0.4
Other income (expense)	1.1	(0.3)	0.5	0.3
Net earnings (loss) before income taxes	14.0	(3.4)	13.8	0.7
Income tax expense	2.1	0.2	2.2	0.2
Net earnings (loss)	11.9%	(3.6)%	11.6%	0.5%

Our revenue by product, by distribution channel and by geographical region is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Revenue by product				
PC card	67%	68%	58%	75%
OEM	30	21	34	15
Mobile	1	7	5	6
Voq	1		1	
Other	1	4	2	4
	100%	100%	100%	100%
Revenue by distribution channel				
Wireless carriers	23%	47%	27%	48%
OEM	30	23	35	17
Resellers	47	29	38	34
Direct and other		1		1
	100%	100%	100%	100%
Revenue by geographical region				
Americas	91%	81%	92%	65%
Europe	5	15	5	18
Asia-Pacific	4	4	3	17



100%

100%

100%

100%

**Results of Operations Three Months Ended September 30, 2004 Compared to Three Months Ended September 30, 2003**

*Revenue*

Revenue amounted to \$59.1 million for the three months ended September 30, 2004, compared to \$26.3 million in the same period of 2003, an increase of 125.3%. The increase in revenue was due primarily to an increase in sales of our PC cards, OEM products and Voq professional phones, including sales of products formerly sold by AirPrime. During the third quarter, we commenced commercial shipment of the AirCard 775 for EDGE networks. In the future, as a percentage of revenue, we expect that PC card and Voq product revenue will increase and that OEM product revenue will decrease.

Our revenue from customers in the Americas, Europe and the Asia-Pacific region comprised 91%, 5% and 4%, respectively, of our total revenue in the third quarter of 2004 and 81%, 15% and 4%, respectively, in the same period of 2003. Our North American business has increased significantly compared to the prior year as a result of strong sales of our PC card and OEM products to North American customers. In Europe, deployments of EDGE and UMTS networks have been gaining momentum and have negatively affected our GSM/GPRS sales in that region. We do not currently have a UMTS product. We expect that North American sales will continue to be strong due to PC card and OEM sales and the addition of new products, such as the Voq professional phone and EDGE products. For similar reasons, we expect European revenue to increase as well. In the third quarter of 2004, three customers individually accounted for more than 10% of our revenue and in aggregate these three customers represented 69% of our revenue.

*Gross margin*

Gross margin amounted to \$23.0 million in the third quarter of 2004, compared to \$10.7 million in the third quarter of 2003. Our gross margin percentage was 39.0% of revenue for the three months ended September 30, 2004, compared to 40.7% of revenue for the three months ended September 30, 2003. Changes in product mix and new product introduction costs resulted in a modest decline in margin for the quarter. During the third quarter of 2004, our sales of products that had a net book value after writedowns of nil were nil.

We expect our gross margin to continue to fluctuate moderately from quarter to quarter as a result of changes in product mix, changes in geographical mix and changes in product cost due to new product introductions.

*Sales and marketing*

Sales and marketing expenses were \$5.6 million in the third quarter of 2004, compared to \$2.7 million in the same period of 2003, an increase of 111.2%. The increase is due primarily to an increase in marketing development costs and costs related to new products, such as the Voq professional phone and products for EDGE networks. The addition of staff from the AirPrime acquisition also contributed to the increase. Sales and marketing expenses as a percentage of revenue decreased to 9.5% in 2004, compared to 10.1% in 2003. This decrease in percentage terms was due primarily to an increase in revenue. We expect to continue to make significant and increased investments in sales and marketing as we introduce new products, such as the Voq professional phone and products for EDGE networks and continue to expand our distribution channels in Europe and the Asia-Pacific region.

*Research and development, net*

Research and development expenses, net of conditionally repayable government research and development funding, amounted to \$6.6 million in the third quarter of 2004, compared to \$4.7 million in the third quarter of 2003, an increase of 40.4%.

Gross research and development expenses, before government research and development funding, were \$7.0 million or 11.7% of revenue in the third quarter of 2004, compared to \$4.7 million, or 17.8% of revenue, in 2003. Repayment of TPC funding of \$0.5 million was included in our gross research and development expenses in the third quarter of 2004, compared to nil in the same period of 2003. Gross research and development expenses increased due to the addition of staff and projects from the AirPrime acquisition and the development of new products, including EDGE products and the Voq professional phone. We expect our gross research and development expenses to continue to increase as we invest in next generation technology and develop new products.

*Administration*

Administration expenses amounted to \$2.4 million, or 4.0% of revenue, in the third quarter of 2004, compared to \$1.3 million, or 5.1% of revenue, in the same period of 2003. The increase is due primarily to an increase in professional fees, insurance costs and the addition of staff from the AirPrime acquisition. No Metricom recovery was recorded in the third quarter of 2004, compared to a \$0.2 million recovery in the same period of 2003. We expect administration expenses to decrease as a percentage of revenue as revenue continues to increase.

*Restructuring and other charges*

In the third quarter of 2004, we incurred restructuring and other charges of \$0.3 million as a result of a change in estimate of the facilities restructuring charge that was originally announced in 2002. The change in estimate reflects the impact of changes in estimated operating costs of the facilities and foreign exchange rates.

In the third quarter of 2003, we incurred restructuring and other charges of \$1.2 million as a result of our acquisition of AirPrime. The charges included writedowns of fixed and intangible assets, severance costs for workforce reductions and an additional facilities restructuring charge.

*Integration costs*

In the third quarter of 2004 we did not incur any integration costs. In the third quarter of 2003, we incurred integration costs of \$1.0 million as a result of our acquisition of AirPrime. The charges include costs of existing staff and contractors retained for the transition period and costs related to integration activities. All of these employees and contractors completed their integration activities and were terminated by December 31, 2003.

*Income tax expense*

Income tax expense amounted to \$1.3 million for the three months ended September 30, 2004, compared to \$0.1 million for the three months ended September 30, 2003. Income tax expense has increased primarily due to expected taxes payable in the United States resulting from our increased earnings.

*Net earnings (loss)*

Our net earnings amounted to \$7.1 million, or diluted earnings per share of \$0.27, in the third quarter of 2004, compared to a net loss of \$0.9 million, or loss per share of \$0.05, in the same period of 2003. Our net earnings were \$7.4 million in the third quarter of 2004, excluding restructuring costs of \$0.3 million, compared to net earnings of \$1.1 million in the third quarter of 2003, excluding restructuring and integration

costs of \$2.2 million and the Metricom recovery of \$0.2 million.

The weighted average diluted number of shares outstanding increased to 26.1 million in 2004, primarily due to the issuance of shares in August 2003 related to the AirPrime acquisition and to our secondary public offering in November 2003, as compared to 18.4 million in the same period of 2003.

***Results of Operations    Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003***

*Revenue*

Revenue amounted to \$152.4 million for the nine months ended September 30, 2004, compared to \$67.1 million in the same period of 2003, an increase of 127.0%. The increase in revenue was due primarily to an increase in sales of our PC card, OEM and mobile products, including sales of products formerly sold by AirPrime. During the first nine months of 2004, we also commenced commercial shipment of the AirCard 580 for CDMA 1xEV-DO networks, the AirCard 555R for CDMA networks in Asia, the MP555 for CDMA 1X, the AirCard 775 for EDGE networks and the Voq Professional Phone. In the future, as a percentage of revenue, we expect that PC card and Voq product revenue will increase and that OEM product revenue will decrease.

Our revenue from customers in the Americas, Europe and the Asia-Pacific region comprised 92%, 5% and 3%,

respectively, of our total revenue for the nine months ended September 30, 2004 and 65%, 18% and 17%, respectively, in the same period of 2003. Our North American business has increased significantly compared to the prior year as a result of strong sales of our PC card, OEM and mobile products to North American customers. In Europe, deployments of EDGE and UMTS networks have been gaining momentum and have negatively affected our GSM/GPRS sales in that region. We do not currently have a UMTS product. We expect that North American sales will continue to be strong due to PC card and OEM sales and the addition of new products, such as the Voq professional phone and EDGE products. For similar reasons, we expect European revenue to increase as well. In the first nine months of 2004, two customers individually accounted for more than 10% of our revenue and in aggregate these two customers represented 51% of our revenue.

#### *Gross margin*

Gross margin amounted to \$60.8 million for the nine months ended September 30, 2004, compared to \$26.9 million in the same period of 2003. Our gross margin percentage was 39.9% of revenue for the nine months ended September 30, 2004, compared to 40.1% of revenue for the nine months ended September 30, 2003. Strong PC card and mobile product margins offset the impact of OEM products that yield lower margins, resulting in a relatively stable margin for the nine month period. During the first nine months of 2004, we sold \$0.2 million of products that had a net book value after writedowns of nil.

We expect our gross margin to fluctuate moderately from quarter to quarter as a result of changes in product mix, changes in geographical mix and changes in product cost due to new product introductions.

#### *Sales and marketing*

Sales and marketing expenses were \$14.2 million for the nine months ended September 30, 2004, compared to \$8.0 million in the same period of 2003, an increase of 77.7%. The increase is due primarily to the addition of staff from the AirPrime acquisition, market development costs and marketing costs related to new products such as the Voq professional phone and products for EDGE networks. Sales and marketing expenses as a percentage of revenue decreased to 9.3% in 2004, compared to 11.9% in 2003. This decrease was due primarily to an increase in revenue. We expect to continue to make significant and increased investments in sales and marketing as we introduce new products, such as the Voq professional phone and products for EDGE networks, and continue to expand our distribution channels in Europe and the Asia-Pacific region.

#### *Research and development, net*

Research and development expenses, net of conditionally repayable government research and development funding, amounted to \$17.3 million for the nine months ended September 30, 2004, compared to \$10.4 million in the same period of 2003, an increase of 66.7%.

Gross research and development expenses, before government research and development funding, were \$19.5 million or 12.8% of revenue in the first nine months of 2004, compared to \$10.9 million or 16.2% of revenue in 2003. Repayment of TPC funding of \$1.4 million was included in our gross research and development expenses in the first nine months of 2004, compared to nil in the same period of 2003. Gross research and development expenses increased due to the addition of staff and projects from the AirPrime acquisition and the development of new products, including EDGE products and the Voq professional phone. We expect our gross research and development expenses to continue to increase as we invest in next generation technology and develop new products.

During 2004, we signed a second agreement with the Government of Canada's Technology Partnerships Canada ( TPC ) program under which we are eligible to receive conditionally repayable research and development funding up to Cdn. \$9.5 million to support the development of a range of third generation wireless technologies. The agreement is effective for development work commencing April 2003. Funding of \$2.2 million was recognized during the nine months ended September 30, 2004, of which \$1.1 million relates to the period from April 1, 2003 to December 31, 2003. We expect that our TPC funding will be based on research and development work completed in each quarter.

*Administration*

Administration expenses amounted to \$6.9 million, or 4.6% of revenue, for the nine months ended September 30, 2004, compared to \$4.4 million, or 6.5% of revenue, in the same period of 2003. The increase is due primarily to an increase in legal fees, consulting fees, insurance costs and the addition of staff from the AirPrime acquisition. Included in administration expense for the nine months ended September 30, 2004 was an additional recovery from Metricom of \$0.4 million, compared to \$0.5 million in the same period of 2003. We expect administration expenses to decrease as a percentage of revenue as revenue continues to increase.

*Restructuring and other charges*

In the nine months ended September 30, 2004, we incurred restructuring and other charges of \$0.3 million as a result of a change in estimate of the facilities restructuring charge that was originally announced in 2002. The change in estimate reflects the impact of changes in estimated operating costs of the facilities and foreign exchange rates.

In the nine months ended September 30, 2003, we incurred restructuring and other charges of \$1.2 million as a result of our acquisition of AirPrime. The charges included writedowns of fixed and intangible assets, severance costs for workforce reductions and an additional facilities restructuring charge.

*Integration costs*

In the nine months ended September 30, 2004 we did not incur any integration costs. In the nine months ended September 30, 2003, we incurred integration costs of \$1.0 million as a result of our acquisition of AirPrime. The charges include costs of existing staff and contractors retained for the transition period and costs related to integration activities. All of these employees and contractors completed their integration activities and were terminated by December 31, 2003.

*Income tax expense*

Income tax expense amounted to \$3.4 million for the nine months ended September 30, 2004, compared to \$0.1 million for the nine months ended September 30, 2003. Income tax expense has increased primarily due to expected taxes payable in the United States resulting from our increased earnings.

*Net earnings*

Our net earnings amounted to \$17.7 million, or diluted earnings per share of \$0.68, for the nine months ended September 30, 2004, compared to net earnings of \$0.3 million, or diluted earnings per share of \$0.02, for the same period of 2003. Excluding the TPC funding of \$1.1 million related to the 2003 period, the Metricom recoveries of \$0.4 million and the restructuring of \$0.3 million, our net earnings for the first nine months of 2004 were \$16.5 million, or diluted earnings per share of \$0.63. Excluding restructuring and integration costs of \$2.2 million and the Metricom recovery of \$0.5 million, our net earnings for the first nine months of 2003 were \$2.1 million, or diluted earnings per share of \$0.12.

The weighted average diluted number of shares outstanding increased to 26.1 million in 2004 due to the issuance of shares in August 2003 related to the AirPrime acquisition and to our secondary public offering in November 2003, as compared to 17.6 million in 2003.



**Contingent Liabilities**

On September 23, 2004, Sierra Wireless America, Inc., as successor to AirPrime, Inc., along with other defendants, was served with the first amended complaint of Joshua Cohen and David Beardsley on behalf of themselves and others similarly situated, which was filed in the U.S. District Court for the Central District of California for violations of federal and state securities laws allegedly occurring prior to the time AirPrime, Inc. was acquired by the Company. We have not yet been required to file our response to the first amended complaint and have given notice to our liability insurance carriers. Although there can be no assurance that an unfavourable outcome of the dispute would not have a material adverse effect on our operating results, liquidity or financial position, we are assessing the first amended complaint and believe the claims are without merit and will vigorously defend them.

During 2002, we executed a settlement agreement with Metricom, one of our U.S. customers, in a Chapter 11 reorganization under U.S. bankruptcy laws, under which all claims and counterclaims were settled. We received the amount of \$1.8 million that has been included in our net loss for 2002. We also received additional recoveries of \$0.3 million and \$0.2 million that have been included in our second and third quarter net earnings for 2003, respectively, and \$0.2 million and \$0.2 million that have been included in our first and second quarter net earnings for 2004, respectively.

Under license agreements, we are committed to royalty payments based on the sales of products using certain technologies. We recognize royalty obligations as determinable in accordance with agreement terms. Where agreements are not finalized, we have recognized our current best estimate of the obligation. When the agreements are finalized, the estimate will be revised accordingly.

We are engaged in other legal actions and believe that the ultimate outcome of these actions will not have a material adverse effect on our operating results, liquidity or financial position.

### **Critical Accounting Policies**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, and we make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent liabilities. On an on-going basis, we evaluate our estimates and judgments, including those related to revenue recognition, adequacy of allowance for doubtful accounts, adequacy of inventory reserve, income taxes and adequacy of warranty reserve. We base our estimates on historical experience and anticipated results and trends and on various other assumptions that we believe are reasonable under the circumstances. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from our estimates. Senior management has discussed with our audit committee the development, selection, and disclosure of accounting estimates used in the preparation of our consolidated financial statements.

During the quarter ended September 30, 2004, we did not adopt any new accounting policies that have a material impact on our consolidated financial statements or make changes to existing accounting policies.

The following critical accounting policies affect our more significant estimates and assumptions used in preparing our consolidated financial statements:

We recognize revenue from sales of products and services upon the later of transfer of title or upon shipment of the product to the customer or rendering of the service, so long as collectibility is reasonably assured. Customers include resellers, original equipment manufacturers, wireless service providers and end-users. We record deferred revenue when we receive cash in advance of the revenue recognition criteria being met.

A significant portion of our revenue is generated from sales to resellers. We recognize revenue on the portion of sales to certain resellers that are subject to provisions allowing various rights of return and stock rotation when the rights have expired or the products have been reported as sold by the resellers.

Funding from research and development agreements, other than government research and development arrangements, is recognized as revenue when certain criteria stipulated under the terms of those funding agreements have been met, and when there is reasonable assurance the funding will be received. Certain research and development funding will be repayable only on the occurrence of specified future events. If such events do not occur, no repayment would be required. We will recognize the liability to repay research and development funding in the period in which conditions arise that would cause research and development funding to be repayable.

We maintain an allowance for doubtful accounts for estimated losses that may arise if any of our customers are unable to make required payments. We consider the following factors when determining if collection is reasonably assured: customer credit-worthiness, past transaction history with the customer, current economic industry trends and changes in customer payment terms. If we have no previous experience with the customer, we typically obtain reports from credit organizations to ensure that the customer has a history of paying its creditors. We may also request financial information, including financial statements, to ensure that the customer has the means of making payment. If these factors indicate collection is not reasonably assured, revenue is deferred until collection becomes reasonably assured, which is generally upon receipt of cash. If the financial condition of any of our customers deteriorates, we may increase our allowance.

We value our inventory at the lower of cost, determined on a first-in-first-out basis, and estimated net realizable value. We assess the need for an inventory writedown based on our assessment of estimated market value using assumptions about future demand and market conditions. Our reserve requirements generally increase as our projected demand requirements decrease, due to market conditions, technological and product life cycle changes and longer than previously expected usage periods. If market conditions are worse than our projections, we may further writedown the value of our inventory.

We currently have intangible assets of \$14.5 million and goodwill of \$20.0 million generated from our acquisition of AirPrime in August 2003. Goodwill is tested for impairment annually, or more often, if an event or circumstance indicates that an impairment loss has been incurred.

The initial goodwill impairment test was completed during the fourth quarter of 2003, which resulted in no impairment loss. We assessed the realizability of goodwill related to our reporting unit during the fourth quarter and determined that its fair value did not have to be re-computed because the components of the reporting unit had not changed since the fair value computation completed at August 12, 2003, the date of acquisition, the previous fair value amount exceeded the carrying amount of the reporting unit by a substantial margin, and no evidence exists to indicate that the current fair value of the reporting unit would be less than its current carrying amount.

We evaluate our deferred income tax assets to assess whether their realization is more likely than not. If their realization is not considered more likely than not, we provide for a valuation allowance. The ultimate realization of our deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. We consider projected future taxable income and tax planning strategies in making our assessment. If we determine that we would not be able to realize our deferred tax assets, we may make an adjustment to our deferred tax assets that would be charged to income.

We accrue product warranty costs in accrued liabilities to provide for the repair or replacement of defective products. Our accrual is based on an assessment of historical experience and management's estimates. If we suffer a decrease in the quality of our products, we may increase our accrual.

Under license agreements, we are committed to royalty payments based on the sales of products using certain technologies. We recognize royalty obligations as determinable in accordance with agreement terms. Where agreements are not finalized, we have recognized our current best estimate of the obligation in accrued liabilities. When the agreements are finalized, the estimate will be revised accordingly.

We recorded a lease provision during 2002 as a result of our restructuring program by estimating the net present value of the future cash outflows over the remaining lease period. The estimate was based on various assumptions including the obtainable sublease rates and the time it will take to find a suitable tenant. These assumptions are influenced by market conditions and the availability of similar space nearby. If market conditions change, we will adjust our provision.

We are engaged in certain legal actions and believe that the ultimate outcome of these actions will not have a material adverse effect on our operating results, liquidity or financial position. We estimate the range of liability related to pending litigation where the amount and range of loss can be reasonably estimated. We record our best estimate of a loss when the loss is considered probable. As additional information becomes available, we assess the potential liability relating to our pending litigation and revise our estimates.

## Liquidity and Capital Resources

### *Operating Activities*

Cash provided by operating activities amounted to \$21.5 million for the first nine months of 2004, compared to cash provided by operating activities of \$10.9 million in the same period of 2003, an improvement of \$10.6 million. The source of cash in 2004 primarily resulted from earnings from operations of \$22.8 million adjusted for non-cash items, inventory levels and changes in other operating assets and liabilities of \$1.3 million. Our working capital has increased significantly from December 31, 2003 as a result of strong revenue and operating expense control. Generally, our working capital requirements will increase or decrease with quarterly revenue levels.

### *Investing Activities*

Cash provided by investing activities was \$31.0 million for the nine months ended September 30, 2004, compared to cash used by investing activities of \$13.8 million during the same period in 2003. The source of cash during the first nine months of 2004 was due primarily to the disposal of long-term investments that were re-invested in investments with maturities less than 90 days. Expenditures on intangible assets were \$1.7 million in 2004, compared to \$3.9 million in 2003, and were primarily for license fees and patents. Capital expenditures were \$5.5 million in 2004, compared to \$1.0 million in 2003, and were primarily for tooling, research and development equipment, computer equipment and software.

We do not have any trading activities that involve any type of commodity contracts that are accounted for at fair value but for which a lack of market price quotations necessitate the use of fair value estimation techniques.

*Financing Activities*

Cash provided by financing activities was \$3.1 million in the first nine months of 2004, compared to a use of cash of \$1.3 million during the same period in 2003, an increase of \$4.4 million. The source of cash in 2004 was primarily from the issuance of common shares upon the exercise of stock options, offset slightly by repayments of our long-term obligations.

As of September 30, 2004, we did not have any off-balance sheet finance or special purpose entities.

*Cash Requirements*

We expect our operations will generate positive net cash during fiscal 2004.

Our near-term cash requirements are primarily related to funding our operations, capital expenditures and other obligations discussed below. We believe our cash and cash equivalents of \$125.9 million, short-term investments of \$1.6 million as of September 30, 2004 and cash generated from operations will be sufficient to fund our expected working and other capital requirements for the next twelve months based on current business plans. Our capital expenditures during 2004 are expected to be primarily for research and development equipment, tooling, licenses and patents. However, we cannot provide assurance that our actual cash requirements will not be greater than we currently expect.

The following table quantifies our future contractual obligations as of September 30, 2004:

Payments due in fiscal	Obligations under Capital		Total
	Operating Leases	Leases	
2004	\$ 734	\$ 115	\$ 849
2005	2,638	319	2,957
2006	2,635	28	2,663
2007	2,707		2,707
2008	2,722		2,722
Thereafter	5,348		5,348
Total	\$ 16,784	\$ 462	\$ 17,246

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We have entered into purchase commitments totaling \$26.7 million with certain contract manufacturers under which we commit to buy a minimum amount of designated products. In certain of these agreements, we may be required to acquire and pay for such products up to the prescribed minimum or forecasted purchases. The terms of the commitment require us to purchase \$26.7 million of product from certain contract manufacturers between October 2004 and December 2004.

### *Sources and Uses of Cash*

In November 2003, we completed a new issue and secondary public offering in the United States and Canada. Our net proceeds after selling commissions and expenses of the offering amounted to approximately \$67.4 million. The net proceeds from the offering are to be used for product development, working capital and general corporate purposes, including acquisitions.

One of our significant sources of funds is expected to be our future operating cash flow. In the past, our revenue was dependent on us fulfilling our commitments in accordance with agreements with major customers. We have completed volume shipments on those contracts. We are now relying on purchase orders with these customers and these customers, like our other customers, will be under no contractual obligation to purchase our products. If they do not make such purchases, our future operating cash flow will be negatively impacted. We have a risk of impairment to our liquidity should there be any interruption to our business operations.

The source of funds for our future capital expenditures and commitments is cash, short-term investments, accounts receivable, research and development funding, borrowings and cash from operations, as follows:

Net cash and short-term investments amounted to \$127.5 million at September 30, 2004, compared to \$85.1 million at December 31, 2003.

Long-term investments amounted to nil at September 30, 2004, compared to \$24.6 million at December 31, 2003.

Accounts receivable amounted to \$29.7 million at September 30, 2004, compared to \$21.6 million at December 31, 2003.

We have a \$10.0 million operating line of credit with a Canadian chartered bank. The credit facility bears interest at prime plus 1.25% and is secured by a general security agreement providing a first charge against all assets. At September 30, 2004, there were no borrowings under this line of credit.

#### **Market Risk Disclosure**

During the third quarter ended September 30, 2004, 89% of our revenue was earned from United States-based customers. Our risk from currency fluctuations between the Canadian and U.S. dollar is reduced by purchasing inventory, other costs of sales and many of our services in U.S. dollars. We are exposed to foreign currency fluctuations because the majority of our research and development, sales and marketing, and administration costs are incurred in Canada. We monitor our exposure to fluctuations between the Canadian and U.S. dollars. For the three and nine months ended September 30, 2004, we have recorded a foreign exchange gain of approximately \$0.3 million and loss of \$0.3 million, respectively. As we have available funds and very little debt, we have not been adversely affected by significant interest rate fluctuations.

With our international expansion into Europe and the Asia-Pacific region, we are transacting business in additional foreign currencies and the potential for currency fluctuations is increasing. The risk associated with currency fluctuations between the U.S. dollar and foreign currencies in Europe and the Asia-Pacific region has been minimal as such transactions have not been material to date. As our business expands in Europe, we expect that we will also continue to be exposed to Euro transactions. To date we have not entered into any futures contracts. To manage our foreign currency risks, we may enter into such contracts should we consider it to be advisable to reduce our exposure to future foreign exchange fluctuations.

Currently, we do not have any hedging activities or derivative instruments, therefore the impact of FAS No. 133 is not material to our financial results.



**Related Party Transactions**

During the three and nine months ended September 30, 2004, there were no material related party transactions.

**Quarterly Results of Operations**

The following tables set forth certain unaudited consolidated statements of operations data for each of the eleven most recent quarters that, in management's opinion, have been prepared on a basis consistent with the audited consolidated financial statements contained in our fiscal 2003 Annual Report. The unaudited consolidated statements of operations data presented below reflects all adjustments, consisting primarily of normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of results for the interim periods. These operating results are not necessarily indicative of results for any future period. You should not rely on them to predict our future performance.

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2004	Quarter Ended		
	March 31	June 30	Sept. 30
Revenue	\$ 41,641	\$ 51,595	\$ 59,149
Cost of goods sold	24,839	30,680	36,107
Gross margin	16,802	20,915	23,042
Expenses:			
Sales and marketing	4,173	4,386	5,604
Research and development, net	4,739	5,991	6,566
Administration	2,064	2,534	2,354
Restructuring and other charges			289
Amortization	636	563	588
	11,612	13,474	15,401
Earnings from operations	5,190	7,441	7,641
Other income (expense)	84	(40)	694
Earnings before income taxes	5,274	7,401	8,335
Income tax expense	704	1,384	1,268
Net earnings	\$ 4,570	\$ 6,017	\$ 7,067
Earnings per share:			
Basic	\$ 0.18	\$ 0.24	\$ 0.28
Diluted	\$ 0.18	\$ 0.23	\$ 0.27
Weighted average number of shares (in thousands):			
Basic	24,986	25,221	25,301
Diluted	26,027	26,248	26,087

2003	Quarter Ended				Year 2003
	March 31	June 30	Sept. 30	Dec. 31	
Revenue	\$ 20,150	\$ 20,736	\$ 26,250	\$ 34,573	\$ 101,709
Cost of goods sold	12,210	12,405	15,566	20,370	60,551
Gross margin	7,940	8,331	10,684	14,203	41,158
Expenses:					
Sales and marketing	2,729	2,590	2,653	3,613	11,585
Research and development, net	2,749	2,947	4,677	5,621	15,994
Administration	1,617	1,451	1,331	2,198	6,597
Restructuring and other charges			1,220		1,220
Integration costs			1,026	921	1,947
Amortization	553	546	590	638	2,327
	7,648	7,534	11,497	12,991	39,670
Earnings (loss) from operations	292	797	(813)	1,212	1,488
Other income (expense)	104	167	(74)	768	965
Earnings (loss) before income taxes	396	964	(887)	1,980	2,453
Income tax expense	35	54	54	55	198
Net earnings (loss)	\$ 361	\$ 910	\$ (941)	\$ 1,925	\$ 2,255
Earnings (loss) per share:					
Basic	\$ 0.02	\$ 0.06	\$ (0.05)	\$ 0.09	\$ 0.12
Diluted	\$ 0.02	\$ 0.05	\$ (0.05)	\$ 0.08	\$ 0.12
Weighted average number of shares (in thousands):					
Basic	16,355	16,375	18,409	22,563	18,442
Diluted	16,718	16,754	18,409	23,383	18,989



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2002	Quarter Ended				Year 2002
	March 31	June 30	Sept. 30	Dec. 31	
Revenue	\$ 16,700	\$ 16,929	\$ 21,083	\$ 22,547	\$ 77,259
Cost of goods sold	10,780	29,677	12,817	15,987	69,261
Gross margin	5,920	(12,748)	8,266	6,560	7,998
Expenses:					
Sales and marketing	2,710	2,920	2,801	3,133	11,564
Research and development, net	4,801	4,615	3,217	2,263	14,896
Administration	1,973	1,837	1,331	(356)	4,785
Restructuring and other charges		13,093		(224)	12,869
Amortization	653	594	529	555	2,331
	10,137	23,059	7,878	5,371	46,445
Earnings (loss) from operations	(4,217)	(35,807)	388	1,189	(38,447)
Other income (expense)	(122)	96	124	149	247
Earnings (loss) before income taxes	(4,339)	(35,711)	512	1,338	(38,200)
Income tax expense		3,424	9	30	3,463
Net earnings (loss)	\$ (4,339)	\$ (39,135)	\$ 503	\$ 1,308	\$ (41,663)
Earnings (loss) per share:					
Basic	\$ (0.27)	\$ (2.40)	\$ 0.03	\$ 0.08	\$ (2.56)
Diluted	\$ (0.27)	\$ (2.40)	\$ 0.03	\$ 0.08	\$ (2.56)
Weighted average number of shares (in thousands):					
Basic	16,263	16,305	16,314	16,334	16,304
Diluted	16,263	16,305	16,539	16,733	16,304

**Selected Annual Information**

Years ended December 31,	2001	2002	2003
Revenue	\$ 62,348	\$ 77,259	\$ 101,709
Net earnings (loss)	(24,269)	(41,663)	2,255
Diluted earnings (loss) per share	(1.50)	(2.56)	0.12
Total assets	110,724	71,089	175,868
Total long-term liabilities	2,720	6,590	3,735

**Forward-looking Statements**

This report contains forward-looking statements that involve risks and uncertainties. These forward-looking statements relate to, among other things, plans and timing for the introduction or enhancement of our services and products, statements about future market conditions, supply and demand conditions, channel inventory and sell through, revenue, gross margin, operating expenses, profits, and other expectations, intentions and plans contained in this report that are not historical fact. Our expectations regarding future revenues and earnings depend in part upon our ability to develop, manufacture, supply and market products that we do not produce today and that meet defined specifications. When used in this report, the words "plan", "expect", "believe", and similar expressions generally identify forward-looking statements. These statements reflect our current expectations. They are subject to a number of risks and uncertainties, including but not limited to, changes in technology and changes in the wireless communications market. In light of the many risks and uncertainties surrounding the wireless communications market, you should understand that we cannot assure you that the forward-looking statements contained in this report will be realized.

**Risk Factors**

Our business is subject to significant risks and past performance is no guarantee of future performance. Some of the risks we face are:

**We have incurred net losses in the past and may not sustain profitability.**

While we had earnings from operations for the year ended December 31, 2003, we have incurred a loss from operations in each of the previous three fiscal years. As of September 30, 2004 our accumulated deficit was \$53.7 million. While we had net earnings of \$17.7 million for the nine months ended September 30, 2004, our ability to achieve and maintain profitability will depend on, among other things, the continued sales of our products and the successful development and commercialization of new products. We cannot predict if the current profitability will be sustainable on a quarterly or an annual basis. As a result, our share price may decline.

If the current profitability does not continue, we may need to raise additional capital in the future. Additional financing may not be available, and even if available, may not be on acceptable terms. We may seek to raise additional capital through an offering of common shares, preference shares or debt, which may result in dilution, and/or the issuance of securities with rights senior to the rights, of the holders of common shares.

**If demand for our current products declines and we are unable to launch successful new products, our revenues will decrease.**

If the markets in which we compete fail to grow, or grow more slowly than we currently anticipate, or if we are unable to establish markets for our new products, it would significantly harm our business, results of operations and financial condition. In addition, demand for one or all of our current products could decline as a result of competition, technological change or other factors.

**If we are unable to design and develop new products that gain sufficient commercial acceptance, we may be unable to maintain our market share or to recover our research and development expenses and our revenues could decline.**

We depend on designing, developing and marketing new products to achieve much of our future growth. Our ability to design, develop and market new products depends on a number of factors, including, but not limited to the following:

Our ability to attract and retain skilled technical employees;

The availability of critical components from third parties;

Our ability to successfully complete the development of products in a timely manner; and

Our ability to manufacture products at an acceptable price and quality.

A failure by us, or our suppliers, in any of these areas, or a failure of new products, such as the Voq professional phone, to obtain commercial acceptance, could mean we receive less revenue than we anticipate and we are unable to recover our research and development expenses, and could result in a decrease in the market price for our shares.

**The loss of any of our material customers could adversely affect our revenue and profitability, and therefore shareholder value.**

We depend on a small number of customers for a significant portion of our revenues. In the last two fiscal years, there have been two different customers that individually accounted for more than 10% of our revenues. In the nine months ended September 30, 2004, two customers individually accounted for more than 10% of our revenue and in aggregate these two customers represented 51% of our revenue. If any of these customers reduce their business with us or suffer from business failure, our revenues and profitability could decline, perhaps materially.

**We may not be able to continue to design products that meet our customer needs and, as a result, our revenue and profitability may decrease.**

We develop products to meet our customers' requirements but, particularly with original equipment manufacturers, current design wins do not guarantee future design wins. If we are unable or choose not to meet our customers' future needs, we may not win their future business and our revenue and profitability may decrease.

**We depend on a few third parties to manufacture our products and supply key components. If they do not manufacture our products properly or cannot meet our needs in a timely manner, we may be unable to fulfill our product delivery obligations and our costs may increase, and our revenue and margins could decrease.**

We outsource a substantial part of the manufacture of our products to third parties and depend heavily on the ability of these manufacturers to meet our needs in a timely and satisfactory manner. Some components used by us may only be available from a small number of suppliers, in some cases from only one supplier. We currently rely on three manufacturers, any of which may terminate the manufacturing contract with us at the end of any contract year. Our reliance on third party manufacturers and suppliers subjects us to a number of risks, including the following:

The absence of guaranteed manufacturing capacity;

Reduced control over delivery schedules, production yields and costs; and

Inability to control the amount of time and resources devoted to the manufacture of our products.

If we are unable to successfully manage any of these risks or to locate alternative or additional manufacturers or suppliers in a timely and cost-effective manner, we may not be able to deliver products in a timely manner. In addition, our results of operations could be harmed by increased costs, reduced revenues and reduced margins.

**We do not have fixed-term employment agreements with our key personnel and the loss of any key personnel may harm our ability to compete effectively.**

None of our officers or other key employees has entered into a fixed-term employment agreement. Our success depends in large part on the abilities and experience of our executive officers and other key employees. Competition for highly skilled management, technical, research and development and other key employees is intense in the wireless communications industry. We may not be able to retain our current key employees or attract and retain additional key employees as needed. The loss of key employees could disrupt our operations and impair our ability to compete effectively.

**We may have difficulty responding to changing technology, industry standards and customer preferences, which could cause us to be unable to recover our research and development expenses and lose revenues.**

The wireless industry is characterized by rapid technological change. Our success will depend in part on our ability to develop products that keep pace with the continuing changes in technology, evolving industry standards and changing customer and end-user preferences and requirements. Our products embody complex technology that may not meet those standards, changes and preferences. In addition, wireless communications service providers require that wireless data systems deployed on their networks comply with their own standards, which may differ from the standards of other providers. We may be unable to successfully address these developments in a timely basis or at all. Our failure



to respond quickly and cost-effectively to new developments through the development of new products or enhancements to existing products could cause us to be unable to recover significant research and development expenses and reduce our revenues.

**Competition from new or established wireless communication companies or from those with greater resources may prevent us from increasing or maintaining our market share and could result in price reductions and reduced revenues.**

The wireless industry is intensely competitive and subject to rapid technological change. We expect competition to intensify. More established and larger companies with greater financial, technical and marketing resources sell products that compete with ours. We also may introduce new products that will put us in direct competition with major new competitors. Existing or future competitors may be able to respond more quickly to technological developments and changes or may independently develop and patent technologies and products that are superior to ours or achieve greater acceptance due to factors such as more favorable pricing or more efficient sales channels. If we are unable to compete effectively with our competitors pricing strategies, technological advances and other initiatives, our market share and revenues may be reduced.

**We depend on third parties to offer wireless data and voice communications services for our products to operate.**

Our products can only be used over wireless data and voice networks operated by third parties. In addition, our future growth depends, in part, on the successful deployment of next generation wireless data and voice networks by third parties for which we are developing products. If these network operators cease to offer effective and reliable service, or fail to market their services effectively, sales of our products will decline and our revenues will decrease.

**Acquisitions of companies or technologies may result in disruptions to our business or may not achieve the anticipated benefits.**

As part of our business strategy, we may acquire additional assets and businesses principally relating to or complementary to our current operations. Any acquisitions and/or mergers by us will be accompanied by the risks commonly encountered in acquisitions of companies. These risks include, among other things:

Exposure to unknown liabilities of acquired companies, including unknown litigation related to acts or omissions of our acquired company and/or its directors and officers prior to the acquisition;

Higher than anticipated acquisition costs and expenses;

Effects of costs and expenses of acquiring and integrating new businesses on our operating results and financial condition;

The difficulty and expense of integrating the operations and personnel of the companies;

Disruption of our ongoing business;

Diversion of management's time and attention away from our remaining business during the integration process;

Failure to maximize our financial and strategic position by the successful incorporation of acquired technology;

The inability to implement uniform standards, controls, procedures and policies;

The loss of key employees and customers as a result of changes in management;

The incurrence of amortization expenses; and

Possible dilution to our shareholders.

In addition, geographic distances may make integration of businesses more difficult. We may not be successful in overcoming these risks or any other problems encountered in connection with any acquisitions. If realized, these risks could reduce shareholder value.

**Others could claim that we infringe on their intellectual property rights, which may result in substantial costs, diversion of resources and management attention and harm to our reputation.**

It is possible that other parties may claim that we have violated their intellectual property rights. Rights to intellectual property can be difficult to verify. Competitors could assert, for example, that former employees of theirs whom we have hired have misappropriated their proprietary information for our benefit. A successful infringement claim against us could damage us in the following ways:

We may be liable for damages and litigation costs, including attorneys' fees;

We may be prohibited from further use of the intellectual property;

We may have to license the intellectual property, incurring licensing fees; and

We may have to develop a non-infringing alternative, which could be costly and delay or result in the loss of sales.

Regardless of the outcome, an infringement claim could result in substantial costs, diversion of resources and management attention and harm to our reputation.

**If we are successful in the design and development of our new products, and there is commercial acceptance of our products, such as the Voq professional phone, others may claim that we infringe on their intellectual property rights, which may result in substantial costs, diversion of resources and management attention and harm our reputation.**

**Misappropriation of our intellectual property could place us at a competitive disadvantage.**

Our intellectual property is important to our success. We rely on a combination of patent protection, copyrights, trademarks, trade secrets, licenses, non-disclosure agreements and other contractual agreements to protect our intellectual property. Third parties may attempt to copy aspects of our products and technology or obtain information we regard as proprietary without our authorization. If we are unable to protect our intellectual property against unauthorized use by others it could have an adverse effect on our competitive position.

Our strategies to deter misappropriation could be inadequate due to the following risks:

Non-recognition of the proprietary nature or inadequate protection of our methodologies in the United States, Canada or foreign countries;

Undetected misappropriation of our intellectual property;

The substantial legal and other costs of protecting and enforcing our rights in our intellectual property; and

Development of similar technologies by our competitors.

In addition, we could be required to spend significant funds and our managerial resources could be diverted in order to defend our rights, which could disrupt our operations.

**As our business expands internationally, we will be exposed to additional risks relating to international operations.**

Our expansion into international operations exposes us to additional risks unique to such international markets, including the following:

Increased credit management risks and greater difficulties in collecting accounts receivable;

Unexpected changes in regulatory requirements, wireless communications standards, exchange rates, trading policies, tariffs and other barriers;

Uncertainties of laws and enforcement relating to the protection of intellectual property;

Language barriers; and

Potential adverse tax consequences.

Furthermore, if we are unable to further develop distribution channels in Europe and the Asia-Pacific region we may not be able to grow our international operations and our ability to increase our revenue will be negatively impacted.

**Government regulation could result in increased costs and inability to sell our products.**

Our products are subject to certain mandatory regulatory approvals in the United States, Canada and other countries in which we operate. In the United States, the Federal Communications Commission regulates many aspects of communications devices. In Canada, similar regulations are administered by the Ministry of Industry, through Industry Canada. Although we have obtained all the necessary Federal Communications Commission, Industry Canada and other required approvals for the products we currently sell, we may not obtain approvals for future products on a timely basis, or at all. In addition, regulatory requirements may change or we may not be able to obtain regulatory approvals from countries other than the United States and Canada in which we may desire to sell products in the future.

**Fluctuations in exchange rates between the United States dollar and the Canadian dollar may affect our operating results.**

We are exposed to fluctuations in the exchange rate between the United States dollar and the Canadian dollar through our operations in Canada. To reduce our risk because of currency fluctuations, we purchase inventory, other cost of sales items and many of our services in United States dollars. If the Canadian dollar rises relative to the United States dollar, our operating results may be negatively impacted. To date, we have not entered into any foreign currency futures contracts as part of a hedging policy, but we have purchased Canadian currency to cover our Canadian currency requirements for the next fiscal quarter. We have entered into distribution agreements in Europe and the Asia-Pacific region that are denominated primarily in U.S. dollars. We expect that as our business expands in Europe and the Asia-Pacific region, we will also be exposed to additional foreign currency transactions and to the associated currency risk. To date, we have not entered into any futures contracts.

## SIERRA WIRELESS, INC.

## Consolidated Statements of Operations and Deficit

(Expressed in thousands of United States dollars, except per share amounts)

(Prepared in accordance with United States generally accepted accounting principles (GAAP))

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Revenue	\$ 59,149	\$ 26,250	\$ 152,385	\$ 67,136
Cost of goods sold	36,107	15,566	91,626	40,181
Gross margin	23,042	10,684	60,759	26,955
Expenses				
Sales and marketing	5,604	2,653	14,163	7,972
Research and development, net	6,566	4,677	17,296	10,373
Administration	2,354	1,331	6,952	4,399
Restructuring and other charges (note 3)	289	1,220	289	1,220
Integration costs (note 4)		1,026		1,026
Amortization	588	590	1,787	1,689
	15,401	11,497	40,487	26,679
Earnings (loss) from operations	7,641	(813)	20,272	276
Other income (expense)	694	(74)	738	197
Earnings (loss) before income taxes	8,335	(887)	21,010	473
Income tax expense	1,268	54	3,356	143
Net earnings (loss)	7,067	(941)	17,654	330
Deficit, beginning of period	(60,722)	(72,293)	(71,309)	(73,564)
Deficit, end of period	\$ (53,655)	\$ (73,234)	\$ (53,655)	\$ (73,234)
Earnings (loss) per share for the period:				
Basic	\$ 0.28	\$ (0.05)	\$ 0.70	\$ 0.02
Diluted	\$ 0.27	\$ (0.05)	\$ 0.68	\$ 0.02
Weighted average number of shares (in thousands)				
Basic	25,301	18,409	25,170	17,054
Diluted	26,087	18,409	26,121	17,564

See accompanying notes to consolidated financial statements.

**SIERRA WIRELESS, INC.**

**Consolidated Statements of Comprehensive Income**

(Expressed in thousands of United States dollars)

(Prepared in accordance with United States GAAP)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net earnings (loss)	\$ 7,067	\$ (941)	\$ 17,654	\$ 330
Other comprehensive income				
Unrealized gain on marketable securities			329	
Reclassification adjustment			(329)	
Comprehensive income (loss)	\$ 7,067	\$ (941)	\$ 17,654	\$ 330

See accompanying notes to consolidated financial statements.

## SIERRA WIRELESS, INC.

## Consolidated Balance Sheets

(Expressed in thousands of United States dollars)

(Prepared in accordance with United States GAAP)

	September 30, 2004 (Unaudited)	December 31, 2003
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 125,939	\$ 70,358
Short-term investments (note 5)	1,587	14,760
Accounts receivable	29,717	21,566
Inventories	8,615	1,511
Prepaid expenses	4,152	2,223
	170,010	110,418
Long-term investments (note 5)		24,639
Fixed assets	9,246	5,985
Intangible assets	14,458	14,620
Goodwill	19,967	19,706
Deferred income taxes	500	500
Other assets	1,726	
	\$ 215,907	\$ 175,868
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 10,862	\$ 5,966
Accrued liabilities	35,651	22,221
Deferred revenue and credits	330	399
Current portion of long-term liabilities	1,033	1,328
Current portion of obligations under capital lease	482	141
	48,358	30,055
Long-term liabilities	1,700	2,266
Obligations under capital lease	216	
Shareholders' equity:		
Share capital (note 6)	218,479	214,047
Warrants	1,538	1,538
Deficit	(53,655)	(71,309)
Accumulated other comprehensive loss	(729)	(729)
	165,633	143,547
	\$ 215,907	\$ 175,868

Contingencies (note 7)



See accompanying notes to consolidated financial statements.

## SIERRA WIRELESS, INC.

## Consolidated Statements of Cash Flows

(Expressed in thousands of United States dollars)

(Prepared in accordance with United States GAAP)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
<b>Cash flows from operating activities:</b>				
Net earnings (loss) for the period	\$ 7,067	\$ (941)	\$ 17,654	\$ 330
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities				
Amortization	1,810	1,672	4,978	4,393
Non-cash restructuring and other charges	289	895	289	895
Loss (gain) on disposal	(62)		(67)	2
Accrued warrants				329
<b>Changes in operating assets and liabilities</b>				
Accounts receivable	(1,114)	(453)	(8,551)	(2,537)
Inventories	(5,680)	2,146	(7,104)	4,460
Prepaid expenses	(142)	167	(3,655)	288
Accounts payable	5,025	(6,432)	4,896	(4,051)
Accrued liabilities	696	6,873	13,169	6,691
Deferred revenue and credits	158	201	(69)	132
Net cash provided by operating activities	8,047	4,128	21,540	10,932
<b>Cash flows from investing activities:</b>				
Business acquisitions		666		(126)
Proceeds on disposal	62		67	4
Purchase of fixed assets	(2,002)	(618)	(5,536)	(975)
Increase in intangible assets	(85)	(2,614)	(1,682)	(3,928)
Purchase of long-term investments			(21,369)	
Proceeds on disposal of long-term investments			46,186	
Purchase of short-term investments	(95)	52	(21,254)	(10,170)
Proceeds on maturity of short-term investments	14,200	1,417	34,564	1,417
Net cash provided by (used in) investing activities	12,080	(1,097)	30,976	(13,778)
<b>Cash flows from financing activities:</b>				
Issue of common shares	217	319	4,432	360
Repayment of long-term liabilities	(537)	(507)	(1,367)	(1,665)
Net cash provided by (used in) financing activities	(320)	(188)	3,065	(1,305)
Net increase (decrease) in cash and cash equivalents	19,807	2,843	55,581	(4,151)

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Cash and cash equivalents, beginning of period		106,132		27,847		70,358		34,841
Cash and cash equivalents, end of period	\$	125,939	\$	30,690	\$	125,939	\$	30,690

See supplementary information (note 8).

See accompanying notes to consolidated financial statements.

**SIERRA WIRELESS, INC.**

**Notes to Consolidated Financial Statements**

(Expressed in thousands of United States dollars, except per share amounts and number of shares)

(Prepared in accordance with United States GAAP)

(Unaudited)

**1. Basis of presentation**

The accompanying interim financial information does not include all disclosures required under United States generally accepted accounting principles for annual financial statements. The accompanying financial information is unaudited and reflects all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of results for the interim periods. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our fiscal 2003 Annual Report.

**2. Significant accounting policies**

These interim financial statements follow the same accounting policies and methods of application as our annual financial statements.

*(a) Principles of consolidation*

Our consolidated financial statements include the accounts of Sierra Wireless, Inc. and its wholly-owned subsidiaries Sierra Wireless Data, Inc., Sierra Wireless America, Inc. (formerly AirPrime, Inc.), Sierra Wireless (UK) Limited, Sierra Wireless (Asia Pacific) Limited, Sierra Wireless SRL and Sierra Wireless ULC from their respective dates of formation or acquisition. We have eliminated all significant intercompany balances and transactions.

*(b) Stock-based compensation*

We have elected under FAS No. 123, Accounting for Stock-based Compensation, to account for employee stock options using the intrinsic value method. This method is described in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and

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related interpretations. As we grant all stock options with an exercise price equal to the market value of the underlying common shares on the date of the grant, no compensation expense is required to be recognized under APB 25. FAS No. 123 uses a fair value method of calculating the cost of stock option grants. Had compensation cost for our employee stock option plan been determined by this method, our net earnings (loss) and earnings (loss) per share would have been as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net earnings (loss):				
As reported	\$ 7,067	\$ (941)	\$ 17,654	\$ 330
Less: Total stock-based employee compensation expense determined under fair value based method for all awards				
Pro forma	(1,331)	(1,333)	(4,227)	(13,438)
	\$ 5,736	\$ (2,274)	\$ 13,427	\$ (13,108)
Basic earnings (loss) per share:				
As reported	\$ 0.28	\$ (0.05)	\$ 0.70	\$ 0.02
Pro forma	0.23	(0.12)	0.53	(0.77)
Diluted earnings (loss) per share:				
As reported	\$ 0.27	\$ (0.05)	\$ 0.68	\$ 0.02
Pro forma	0.22	(0.12)	0.52	(0.77)

We recognize the calculated benefit at the date of granting the stock options on a straight-line basis over the shorter of the expected service period and the vesting period.

We have estimated the fair value of each option on the date of the grant using the Black-Scholes option-pricing model with the following assumptions:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Expected dividend yield				
Expected stock price volatility	86%	102%	95%	103%
Risk-free interest rate	3.84%	3.77%	3.64%	3.82%
Expected life of options	4 years	4 years	4 years	4 years
Weighted average fair value of options granted	\$ 11.91	\$ 6.14	\$ 16.80	\$ 5.23

(c) *Recent accounting pronouncements*

In March 2004, the Financial Accounting Standards Board ( FASB ) issued an Exposure Draft of a proposed Statement of Financial Accounting Standards entitled Share-Based Payment. This proposed statement addresses accounting for stock-based compensation and would result in the fair value of all stock-based compensation arrangements, including options, being recognized as an expense in a company's financial statements as opposed to supplemental disclosure in the notes to financial statements. The proposed Statement would eliminate the ability to account for stock-based compensation transactions using APB Opinion No. 25. If approved, the proposed statement, as amended, currently provides that it would be applied to public entities, prospectively, for interim or annual periods beginning after June 15, 2005.

**3. Restructuring and other charges**

In the third quarter of 2004, we recorded an additional facilities restructuring charge of \$289 related to a change in estimate of the future operating expenses and the foreign exchange loss on the Canadian dollar denominated liability.

In the third quarter of 2003, we incurred restructuring and other charges of \$1,220 as a result of our acquisition of AirPrime.

The following table summarizes the changes in the provision for restructuring and other charges for the nine months ended September 30, 2004 and the balance of the provision at September 30, 2004.

Facilities Restructuring	Other	Total
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Balance at December 31, 2003	\$	3,594	\$	77	\$	3,671
Additional charges		289				289
Cash payments		(1,150)		(24)		(1,174)
Balance at September 30, 2004	\$	2,733	\$	53	\$	2,786

**4. Integration costs**

In the third quarter of 2003, we also incurred integration costs related to the AirPrime acquisition of \$1,026, which included the costs of 13 existing employees retained for the transition period. All of these employees completed their integration activities and were terminated by December 31, 2003.

## 5. Investments

Investments, all of which are classified as available-for-sale, were comprised as follows:

	Short-term		Long-term	
	September 30, 2004	December 31, 2003	September 30, 2004	December 31, 2003
Government treasury bills	\$ 1,587	\$ 11,827	\$	\$
Bankers acceptances		1,937		
Commercial paper		996		
Government bonds				24,639
	\$ 1,587	\$ 14,760	\$	\$ 24,639

Our short-term investments all have contractual maturities of less than one year.

During the second quarter of 2004, we liquidated our bond portfolio and no significant gain or loss was realized. At September 30, 2004 there were no significant unrealized holding gains or losses on available-for-sale securities.

## 6. Share capital

Changes in the issued and outstanding common shares are as follows:

	Number of Shares	Amount
Balance at December 31, 2003	24,822,071	\$ 214,047
Stock option exercises	335,835	3,194
Balance at March 31, 2004	25,157,906	217,241
Stock option exercises	123,839	1,021
Balance at June 30, 2004	25,281,745	218,262
Stock option exercises	44,480	217
Balance at September 30, 2004	25,326,225	\$ 218,479

The following table summarizes the stock options outstanding as at September 30, 2004:

Range of Exercise Prices	Number of Shares	Options Outstanding		Options Exercisable	
		Weighted Average Remaining	Weighted Average	Number Exercisable	Weighted Average



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	Contractual Life		Exercise Price		Exercise Price	
	In years		Cdn.\$	U.S.\$	Cdn.\$	U.S.\$
\$ 0.71 \$1.19 (Cdn.\$0.90 Cdn.\$1.50)	33,164	3.0	\$ 1.30	\$ 1.03	33,164	\$ 1.30 \$ 1.03
\$ 1.20 \$2.78 (Cdn.\$1.51 Cdn.\$3.50)	327,779	2.9	3.35	2.66	138,239	3.29 2.61
\$ 2.79 \$9.52 (Cdn.\$3.51 Cdn.\$12.00)	283,225	3.8	9.44	7.50	82,923	8.81 6.99
\$ 9.53 \$15.87 (Cdn.\$12.01 Cdn.\$20.00)	135,009	2.9	16.40	13.01	58,719	15.40 12.22
\$ 15.88 \$23.81 (Cdn.\$20.01 Cdn.\$30.00)	469,667	3.9	22.14	17.57	74,160	24.29 19.28
\$ 23.82 \$139.72 (Cdn.\$30.01 Cdn.\$176.05)	462,080	3.9	41.55	32.98	58,215	91.77 72.83
	1,710,924	3.6	16.53	10.35	445,420	20.82 16.53

The options outstanding at September 30, 2004 expire between November 2004 and September 2009.

## 7. Contingencies

### *(a) Contingent liability on sale of products*

(i) Under license agreements, we are committed to royalty payments based on the sales of products using certain technologies. We recognize royalty obligations as determinable in accordance with agreement terms. Where agreements are not finalized, we have recognized our current best estimate of the obligation. When the agreements are finalized, the estimate will be revised accordingly.

(ii) Under certain research and development funding agreements, we are contingently liable to repay up to \$3,262. Repayment for certain of the research and development funding agreements is contingent upon reaching certain revenue levels for specified products.

(iii) Under an agreement with the Government of Canada's Technology Partnerships Canada (TPC) program, we have received Cdn. \$9,999 to support the development of a range of third generation wireless technologies. Under the terms of the agreement, an amount up to a maximum of Cdn. \$13,000 is to be repaid based on annual sales, in excess of certain minimum amounts, of specified products commencing in 2004. During the nine months ended September 30, 2004, we claimed nil (2003 \$482) that has been recorded as a reduction of research and development expense. During the three and nine months ended September 30, 2004, we have recorded, in research and development expense, the repayment of \$544 and \$1,371, respectively. In addition, we issued warrants to TPC to purchase 138,696 common shares on December 30, 2003, valued at Cdn. \$2,000 based on the Black-Scholes pricing model. The warrants are exercisable at Cdn \$20.49 per share for a term of five years from December 30, 2003. As of September 30, 2004 no warrants have been exercised.

In March 2004, we entered into a second agreement with TPC under which we are eligible to receive conditionally repayable research and development funding up to Cdn. \$9,540 to support the development of a range of third generation wireless technologies. The agreement is effective April 2003. During the three and nine months ended September 30, 2004, we have claimed \$380 and \$2,170, respectively, which has been recorded as a reduction of research and development expense. Under the terms of the agreement, repayment based on a percentage of annual sales, in excess of certain minimum amounts, will be made over the period from April 2003 to December 2011. If the payments during this period are less than Cdn. \$16,455, payments will continue subsequent to December 2011 until the earlier of when the amount is reached or December 2014.

(iv) We accrue product warranty costs, when we sell the related products, to provide for the repair or replacement of defective products. Our accrual is based on an assessment of historical experience and on management's estimates. An analysis of changes in the liability for product warranties follows:

Balance at December 31, 2003	\$	2,341
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Provisions		380
Expenditures		(267)
Balance at March 31, 2004		2,454
Provisions		631
Expenditures		(220)
Balance at June 30, 2004		2,865
Provisions		973
Expenditures		(822)
Balance at September 30, 2004	\$	3,016

*(b) Other commitments*

We have entered into purchase commitments totaling \$26,651 with certain contract manufacturers under which we commit to buy a minimum amount of designated products between October 2004 and December 2004. In certain of these agreements, we may be required to acquire and pay for such products up to the prescribed minimum or forecasted purchases.

*(c) Legal proceedings*

We are engaged in certain legal actions and believe that the ultimate outcome of these actions will not have a material adverse effect on our operating results, liquidity or financial position.

**8. Supplementary information**

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Cash received for				
Interest	\$ 381	\$ 95	\$ 1,144	\$ 259
Income taxes			4	4
Cash paid for				
Interest	12	12	17	56
Income taxes	24		272	62
Non-cash financing activities				
Purchase of fixed assets funded by obligations under capital lease	161		774	113
Issuance of common shares on acquisition		22,377		22,377

**9. Comparative figures**

We have reclassified certain of the figures presented for comparative purposes to conform to the financial statement presentation we adopted for the current period.

**SIERRA WIRELESS, INC.**



**THIRD QUARTER REPORT**

**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004**





**SIERRA WIRELESS, INC.**

**CHAIRMAN S MESSAGE**

**TO OUR SHAREHOLDERS**

We continued to set new records in the third quarter of 2004, generating revenue of \$59.1 million, net earnings of \$5.7 million and positive cash flow from operations.

**Results for Q3 2004 Compared to Q3 2003**

For the three months ended September 30, 2004, our revenue climbed 125% to \$59.1 million, from \$26.3 million in the third quarter of 2003. The revenue increase reflects strong sales of our PC cards and embedded modules, particularly in North American markets.

Gross margin percentage decreased to 38.8% of revenue, from 40.5% of revenue in the comparable quarter as a result of changes in product mix and new product introduction costs. Third quarter operating expenses were \$16.6 million, compared to \$12.5 million for the same period in 2003. The increase in operating expenses reflects additional costs to generate increased revenues, product and market development costs, including costs for the AirCard 775® for EDGE networks and the Voq Professional Phone™, and an additional facilities charge which was comprised mainly of a foreign exchange adjustment.

Effective January 1, 2004, we adopted the fair value recognition provisions of the amended Canadian Institute of Chartered Accountants recommendations that require an estimate of the fair value of stock-based awards be charged to earnings. The charge to earnings for compensation expense related to employee stock options was \$1.3 million and \$1.3 million for the three months ended September 30, 2004 and September 30, 2003, respectively.

Net earnings for the third quarter of 2004 increased to \$5.7 million, or diluted earnings per share of \$0.22, from a net loss of \$2.0 million, or loss per share of \$0.11, in the third quarter of 2003. Excluding the restructuring and integration costs and Metricom recovery, the net loss for the third quarter of 2003 was \$0.3 million, or loss per share of \$0.02.

**Business Developments**

The third quarter included a number of business and corporate developments:

Progress on Products for CDMA 2000 Networks and Channels:

We announced a distribution agreement with Premier Wireless Solutions for our embedded CDMA modules. Under the agreement, Premier Wireless, a distributor of wireless machine-to-machine fixed and mobile communications services and products, will distribute and offer integration support for the Sierra Wireless EM3420 embedded module.

We announced an agreement with Tirumala Seven Hills Pvt Ltd. ( TSH ), a telecommunications company in India, to distribute the award winning AirCard 555 wide area wireless network card to the India marketplace. We expect to commence commercial shipments of the AirCard 555 to TSH in the fourth quarter of 2004.

We announced that we are supplying Sierra Wireless EM3420 embedded modules to Symbol Technologies, Inc. for its MC9000 family of industrial mobile computing devices. Symbol's rugged handheld computers scan, send, and retrieve data wirelessly, moving information from the factory, to the warehouse, to the sales floor, and to the point of business activity, in industries ranging from manufacturing and retail, to logistics and transportation.

The Treo 600 Smartphone by palmOne, featuring an integrated Sierra Wireless EM3420 embedded module, was certified by and became available from Verizon Wireless.

Progress on Products for GSM/GPRS/EDGE Networks and Channels:

We signed an agreement with Onda Communication Spa to distribute our first EDGE product, the ONDA EDGE/GPRS N775 PC Card, for use on the Telecom Italia Mobile GSM, GPRS and EDGE Network. The commercial launch marks the worldwide premiere of Sierra Wireless EDGE product line.

We announced an agreement with Intel to deliver integrated wireless connectivity solutions to mobile professionals worldwide beginning in early 2005. The solution combines the new Intel® Centrino mobile technology-based notebook WLAN and a Sierra Wireless AirCard 775 EDGE PC Card for WWAN, together with wireless data services from a local carrier. Customers purchasing the solution will be able to use their notebook computers to access and manage wireless connections through a single software interface and a single account for billing.

Subsequent to the end of the third quarter, we announced that the AirCard 775 wireless wide area network card for EDGE networks is now available on the AT&T Wireless EDGE network for \$299.99. Customers who sign up for unlimited data rate plans are eligible for a \$150 rebate. The AirCard 775 provides mobile users with data rates up to three times faster than on GPRS networks, delivering fast, wireless connectivity to the Internet, e-mail, and corporate applications.

Progress on the Voq Professional Phone:

Together with KPN, we announced a global first with the commercial availability of our Voq Professional Phone throughout the Netherlands. The Voq Professional Phone is a Microsoft Windows Mobile-based Smartphone. KPN is distributing the Voq via its distribution channels at a retail price of \$99 in combination with a two-year Business Select subscription and a 5Mb GPRS data package.

We extended commercial availability of the Voq Professional Phone across Europe with a number of key distribution partners. The Voq is now available for purchase from A & C Systems in Belgium, Luxemburg, and The Netherlands; from BagLAN in Turkey; from Cedros in Austria, Germany, and Switzerland; from Daimler in the Nordics; from Dangaard Telecom in Western Europe; from Hugh Symons Mobile Computing and Yes Telecom in the United Kingdom; from Speeka in Italy; and from Xacom Comunicaciones in France and Spain.

In September, the Voq Professional Phone became available through members of Intel's Product Dealer program, including TigerDirect, Tech Depot and CellStar Corporation. Intel Product Dealers are active resellers of Intel products, with access to marketing resources, enhanced technical support, and superior training options offered by Intel.

We extended availability of the Voq Professional Phone through Insight, MobilePlanet, and RCS Computer Experience. The Voq is available at select reseller locations and online, for the end-user price of US \$499, with activation on the AT&T Wireless network.

We announced distribution agreements with Brightpoint and Cellstar to distribute the Voq Professional Phone in the North American market. In addition, we announced network approval for the Voq on the AT&T Wireless GSM/GPRS network.

Corporate Developments:

We announced a number of management changes, including the appointment of Jason W. Cohenour to Chief Operating Officer, Jim Kirkpatrick to Chief Technical Officer and Bill Dodson to Senior Vice-President, Operations. We also reported the resignation of Senior Vice-President, Marketing, Andrew S. G. Harries, who has left the company to pursue a new business opportunity.

**Outlook**

We anticipate strong operating results in the fourth quarter of 2004, with continued growth in our revenue and earnings. We expect to make significant CDMA module shipments to palmOne for the Treo 600 during the fourth quarter. By year-end we expect to have completed the shipment of orders on hand and currently do not have visibility on further shipments for this product with palmOne.

We continue to invest in new products, including products for EVDO, EDGE and UMTS networks, and to invest in expanding distribution and sell through for our products including the Voq Professional Phone. These investments are motivated by our goals of continued industry leadership and profitable growth.

/s/ David B. Sutcliffe

David B. Sutcliffe  
Chairman and Chief Executive Officer

This report contains forward-looking statements that involve risks and uncertainties. These forward-looking statements relate to, among other things, plans and timing for the introduction or enhancement of our services and products, statements about future market conditions, supply and demand conditions, and other expectations, intentions and plans contained in this report that are not historical fact. Our expectations regarding future revenues and earnings depend upon our ability to develop, manufacture, supply and market products that we do not produce today and that meet defined specifications. When used in this report, the words "plan", "expect", "believe", and similar expressions generally identify forward-looking statements. These statements reflect our current expectations. They are subject to a number of risks and uncertainties, including, but not limited to, changes in technology and changes in the wireless communications market. In light of the many risks and uncertainties surrounding the wireless communications market, you should understand that we cannot assure you that the forward-looking statements contained in this report will be realized.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion of our consolidated financial condition and results of operations, as of November 1, 2004, has been prepared in accordance with United States generally accepted accounting principles (GAAP), with a reconciliation to Canadian GAAP. Except where otherwise specifically indicated, all amounts are expressed in United States dollars.*

*Additional information related to Sierra Wireless, Inc., including our Annual Information Form, may be found on SEDAR at [www.sedar.com](http://www.sedar.com).*

**Overview**

We provide highly differentiated wireless solutions worldwide. We develop and market a broad range of products that include wireless data modems for portable computers, embedded modules for original equipment manufacturers, or OEMs, rugged vehicle-mounted modems and mobile phones. Our products permit users to access wireless data and voice networks using notebook computers, personal digital assistants, or PDAs, vehicle-based systems and mobile phones.

Wireless data communications is an expanding market positioned at the convergence of wireless communications, portable computing and the Internet, each of which we believe represents a growing market. Our products are based on open standards, including the Internet protocol, and operate on the networks of major wireless communications service providers.

Our products are primarily used by businesses and government organizations to enable their employees access to a wide range of wireless data applications including Internet access, e-mail, messaging, corporate intranet access, remote database inquiry and computer aided dispatch. We sell our products through indirect channels, including wireless operators, resellers and OEMs.

Beginning in fiscal 2001, there was a slowdown in enterprise spending and an overall economic slowdown that impacted our business. The trend intensified during fiscal 2002 and continued into fiscal 2003. Reasons for the market deterioration included a general economic slowdown, customer bankruptcies, network build-out delays and limited availability of capital. During the latter part of 2003 and the first nine months of 2004, we experienced stronger than expected demand.

During the third quarter of 2004, our revenue increased 125.3% to \$59.1 million, compared to \$26.3 million in the third quarter of 2003, as a result of strong revenue from our PC card and OEM products, including products formerly sold by AirPrime, Inc. ( AirPrime ). Our revenue from customers in the Americas, Europe and the Asia-Pacific region comprised 91%, 5% and 4%, respectively, of our total revenue in the third quarter of 2004 and 81%, 15% and 4%, respectively, in the same period of 2003. Our North American business has increased significantly compared to the prior year as a result of strong sales of our PC card and OEM products to North American customers. Our North American business continues to be dominated by near term demand from channels rather than by long-term, large volume commitments. In Europe, deployments of EDGE and UMTS networks have been gaining momentum and have negatively affected our GSM/GPRS sales in that region. We do not currently have a UMTS product. During the third quarter, we began commercial shipments of the AirCard® 775 for EDGE networks to customers in North America and Europe.

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Operating expenses were \$15.4 million in the third quarter of 2004 and increased from \$11.5 million in the prior year due to additional costs incurred in generating increased revenue, the acquisition of AirPrime in August 2003, and costs related to the development and marketing of new products, including products for EDGE networks and the Voq professional phone.

Net earnings were \$7.1 million, or diluted earnings per share of \$0.27, in the third quarter of 2004, compared to a loss of \$0.9 million, or loss per share of \$0.05, in the same period of 2003. Our improvement in net earnings was attributable to an increase in revenue, strong margins, operating cost control and a reduction in restructuring and integration costs that were related to the acquisition of AirPrime.

Our balance sheet remains strong, with \$127.5 million of cash and short and long-term investments, compared to \$109.7 million at December 31, 2003. During the third quarter of 2004, we generated \$8.0 million in cash from operations, compared to \$4.1 million in the same period of 2003.



**Results of Operations**

The following table sets forth our operating results for the three and nine months ended September 30, 2004, expressed as a percentage of revenue:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	61.0	59.3	60.1	59.9
Gross margin	39.0	40.7	39.9	40.1
Expenses				
Sales and marketing	9.5	10.1	9.3	11.9
Research and development, net	11.1	17.8	11.3	15.5
Administration	4.0	5.1	4.6	6.5
Restructuring and other charges	0.5	4.7	0.2	1.8
Integration costs		3.9		1.5
Amortization	1.0	2.2	1.2	2.5
	26.1	43.8	26.6	39.7
Earnings (loss) from operations	12.9	(3.1)	13.3	0.4
Other income (expense)	1.1	(0.3)	0.5	0.3
Net earnings (loss) before income taxes	14.0	(3.4)	13.8	0.7
Income tax expense	2.1	0.2	2.2	0.2
Net earnings (loss)	11.9%	(3.6)%	11.6%	0.5%

Our revenue by product, by distribution channel and by geographical region is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Revenue by product				
PC card	67%	68%	58%	75%
OEM	30	21	34	15
Mobile	1	7	5	6
Voq	1		1	
Other	1	4	2	4
	100%	100%	100%	100%
Revenue by distribution channel				
Wireless carriers	23%	47%	27%	48%
OEM	30	23	35	17
Resellers	47	29	38	34
Direct and other		1		1
	100%	100%	100%	100%
Revenue by geographical region				
Americas	91%	81%	92%	65%
Europe	5	15	5	18
Asia-Pacific	4	4	3	17

100%

100%

100%

100%

***Results of Operations Three Months Ended September 30, 2004 Compared to Three Months Ended September 30, 2003***

*Revenue*

Revenue amounted to \$59.1 million for the three months ended September 30, 2004, compared to \$26.3 million in the same period of 2003, an increase of 125.3%. The increase in revenue was due primarily to an increase in sales of our PC cards, OEM products and Voq professional phones, including sales of products formerly sold by AirPrime. During the third quarter, we commenced commercial shipment of the AirCard 775 for EDGE networks. In the future, as a percentage of revenue, we expect that PC card and Voq product revenue will increase and that OEM product revenue will decrease.

Our revenue from customers in the Americas, Europe and the Asia-Pacific region comprised 91%, 5% and 4%, respectively, of our total revenue in the third quarter of 2004 and 81%, 15% and 4%, respectively, in the same period of 2003. Our North American business has increased significantly compared to the prior year as a result of strong sales of our PC card and OEM products to North American customers. In Europe, deployments of EDGE and UMTS networks have been gaining momentum and have negatively affected our GSM/GPRS sales in that region. We do not currently have a UMTS product. We expect that North American sales will continue to be strong due to PC card and OEM sales and the addition of new products, such as the Voq professional phone and EDGE products. For similar reasons, we expect European revenue to increase as well. In the third quarter of 2004, three customers individually accounted for more than 10% of our revenue and in aggregate these three customers represented 69% of our revenue.

*Gross margin*

Gross margin amounted to \$23.0 million in the third quarter of 2004, compared to \$10.7 million in the third quarter of 2003. Our gross margin percentage was 39.0% of revenue for the three months ended September 30, 2004, compared to 40.7% of revenue for the three months ended September 30, 2003. Changes in product mix and new product introduction costs resulted in a modest decline in margin for the quarter. During the third quarter of 2004, our sales of products that had a net book value after writedowns of nil were nil.

We expect our gross margin to continue to fluctuate moderately from quarter to quarter as a result of changes in product mix, changes in geographical mix and changes in product cost due to new product introductions.

*Sales and marketing*

Sales and marketing expenses were \$5.6 million in the third quarter of 2004, compared to \$2.7 million in the same period of 2003, an increase of 111.2%. The increase is due primarily to an increase in marketing development costs and costs related to new products, such as the Voq professional phone and products for EDGE networks. The addition of staff from the AirPrime acquisition also contributed to the increase. Sales and marketing expenses as a percentage of revenue decreased to 9.5% in 2004, compared to 10.1% in 2003. This decrease in percentage terms was due primarily to an increase in revenue. We expect to continue to make significant and increased investments in sales and marketing as we introduce new products, such as the Voq professional phone and products for EDGE networks and continue to expand our distribution channels in Europe and the Asia-Pacific region.

*Research and development, net*

Research and development expenses, net of conditionally repayable government research and development funding, amounted to \$6.6 million in the third quarter of 2004, compared to \$4.7 million in the third quarter of 2003, an increase of 40.4%.

Gross research and development expenses, before government research and development funding, were \$7.0 million or 11.7% of revenue in the third quarter of 2004, compared to \$4.7 million, or 17.8% of revenue, in 2003. Repayment of TPC funding of \$0.5 million was included in our gross research and development expenses in the third quarter of 2004, compared to nil in the same period of 2003. Gross research and development expenses increased due to the addition of staff and projects from the AirPrime acquisition and the development of new products, including EDGE products and the Voq professional phone. We expect our gross research and development expenses to continue to increase as we invest in next generation technology and develop new products.

*Administration*

Administration expenses amounted to \$2.4 million, or 4.0% of revenue, in the third quarter of 2004, compared to \$1.3 million, or 5.1% of revenue, in the same period of 2003. The increase is due primarily to an increase in professional fees, insurance costs and the addition of staff from the AirPrime acquisition. No Metricom recovery was recorded in the third quarter of 2004, compared to a \$0.2 million recovery in the same period of 2003. We expect administration expenses to decrease as a percentage of revenue as revenue continues to increase.

*Restructuring and other charges*

In the third quarter of 2004, we incurred restructuring and other charges of \$0.3 million as a result of a change in estimate of the facilities restructuring charge that was originally announced in 2002. The change in estimate reflects the impact of changes in estimated operating costs of the facilities and foreign exchange rates.

In the third quarter of 2003, we incurred restructuring and other charges of \$1.2 million as a result of our acquisition of AirPrime. The charges included writedowns of fixed and intangible assets, severance costs for workforce reductions and an additional facilities restructuring charge.

*Integration costs*

In the third quarter of 2004 we did not incur any integration costs. In the third quarter of 2003, we incurred integration costs of \$1.0 million as a result of our acquisition of AirPrime. The charges include costs of existing staff and contractors retained for the transition period and costs related to integration activities. All of these employees and contractors completed their integration activities and were terminated by December 31, 2003.

*Income tax expense*

Income tax expense amounted to \$1.3 million for the three months ended September 30, 2004, compared to \$0.1 million for the three months ended September 30, 2003. Income tax expense has increased primarily due to expected taxes payable in the United States resulting from our increased earnings.

*Net earnings (loss)*

Our net earnings amounted to \$7.1 million, or diluted earnings per share of \$0.27, in the third quarter of 2004, compared to a net loss of \$0.9 million, or loss per share of \$0.05, in the same period of 2003. Our net earnings were \$7.4 million in the third quarter of 2004, excluding restructuring costs of \$0.3 million, compared to net earnings of \$1.1 million in the third quarter of 2003, excluding restructuring and integration

costs of \$2.2 million and the Metricom recovery of \$0.2 million.

The weighted average diluted number of shares outstanding increased to 26.1 million in 2004, primarily due to the issuance of shares in August 2003 related to the AirPrime acquisition and to our secondary public offering in November 2003, as compared to 18.4 million in the same period of 2003.

***Results of Operations    Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003***

*Revenue*

Revenue amounted to \$152.4 million for the nine months ended September 30, 2004, compared to \$67.1 million in the same period of 2003, an increase of 127.0%. The increase in revenue was due primarily to an increase in sales of our PC card, OEM and mobile products, including sales of products formerly sold by AirPrime. During the first nine months of 2004, we also commenced commercial shipment of the AirCard 580 for CDMA 1xEV-DO networks, the AirCard 555R for CDMA networks in Asia, the MP555 for CDMA 1X, the AirCard 775 for EDGE networks and the Voq Professional Phone. In the future, as a percentage of revenue, we expect that PC card and Voq product revenue will increase and that OEM product revenue will decrease.

Our revenue from customers in the Americas, Europe and the Asia-Pacific region comprised 92%, 5% and 3%, respectively, of our total revenue for the nine months ended September 30, 2004 and 65%, 18% and 17%, respectively, in the same period of 2003.

Our North American business has increased significantly compared to the prior year as a result of strong sales of our PC card, OEM and mobile products to North American customers. In Europe, deployments of EDGE and UMTS networks have been gaining momentum and have negatively affected our GSM/GPRS sales in that region. We do not currently have a UMTS product. We expect that North American sales will continue to be strong due to PC card and OEM sales and the addition of new products, such as the Voq professional phone and EDGE products. For similar reasons, we expect European revenue to increase as well. In the first nine months of 2004, two customers individually accounted for more than 10% of our revenue and in aggregate these two customers represented 51% of our revenue.

#### *Gross margin*

Gross margin amounted to \$60.8 million for the nine months ended September 30, 2004, compared to \$26.9 million in the same period of 2003. Our gross margin percentage was 39.9% of revenue for the nine months ended September 30, 2004, compared to 40.1% of revenue for the nine months ended September 30, 2003. Strong PC card and mobile product margins offset the impact of OEM products that yield lower margins, resulting in a relatively stable margin for the nine month period. During the first nine months of 2004, we sold \$0.2 million of products that had a net book value after writedowns of nil.

We expect our gross margin to fluctuate moderately from quarter to quarter as a result of changes in product mix, changes in geographical mix and changes in product cost due to new product introductions.

#### *Sales and marketing*

Sales and marketing expenses were \$14.2 million for the nine months ended September 30, 2004, compared to \$8.0 million in the same period of 2003, an increase of 77.7%. The increase is due primarily to the addition of staff from the AirPrime acquisition, market development costs and marketing costs related to new products such as the Voq professional phone and products for EDGE networks. Sales and marketing expenses as a percentage of revenue decreased to 9.3% in 2004, compared to 11.9% in 2003. This decrease was due primarily to an increase in revenue. We expect to continue to make significant and increased investments in sales and marketing as we introduce new products, such as the Voq professional phone and products for EDGE networks, and continue to expand our distribution channels in Europe and the Asia-Pacific region.

#### *Research and development, net*

Research and development expenses, net of conditionally repayable government research and development funding, amounted to \$17.3 million for the nine months ended September 30, 2004, compared to \$10.4 million in the same period of 2003, an increase of 66.7%.

Gross research and development expenses, before government research and development funding, were \$19.5 million or 12.8% of revenue in the first nine months of 2004, compared to \$10.9 million or 16.2% of revenue in 2003. Repayment of TPC funding of \$1.4 million was included in our gross research and development expenses in the first nine months of 2004, compared to nil in the same period of 2003. Gross research and development expenses increased due to the addition of staff and projects from the AirPrime acquisition and the development of new products, including EDGE products and the Voq professional phone. We expect our gross research and development expenses to continue to increase as we invest in next generation technology and develop new products.

During 2004, we signed a second agreement with the Government of Canada's Technology Partnerships Canada ( TPC ) program under which we are eligible to receive conditionally repayable research and development funding up to Cdn. \$9.5 million to support the development of a range of third generation wireless technologies. The agreement is effective for development work commencing April 2003. Funding of \$2.2 million was recognized during the nine months ended September 30, 2004, of which \$1.1 million relates to the period from April 1, 2003 to December 31, 2003. We expect that our TPC funding will be based on research and development work completed in each quarter.

*Administration*

Administration expenses amounted to \$6.9 million, or 4.6% of revenue, for the nine months ended September 30, 2004, compared to \$4.4 million, or 6.5% of revenue, in the same period of 2003. The increase is due primarily to an increase in legal fees, consulting fees, insurance costs and the addition of staff from the AirPrime acquisition. Included in administration expense for the nine months ended September 30, 2004 was an additional recovery from Metricom of \$0.4 million, compared to \$0.5 million in the same period of 2003. We expect administration expenses to decrease as a percentage of revenue as revenue continues to increase.



*Restructuring and other charges*

In the nine months ended September 30, 2004, we incurred restructuring and other charges of \$0.3 million as a result of a change in estimate of the facilities restructuring charge that was originally announced in 2002. The change in estimate reflects the impact of changes in estimated operating costs of the facilities and foreign exchange rates.

In the nine months ended September 30, 2003, we incurred restructuring and other charges of \$1.2 million as a result of our acquisition of AirPrime. The charges included writedowns of fixed and intangible assets, severance costs for workforce reductions and an additional facilities restructuring charge.

*Integration costs*

In the nine months ended September 30, 2004 we did not incur any integration costs. In the nine months ended September 30, 2003, we incurred integration costs of \$1.0 million as a result of our acquisition of AirPrime. The charges include costs of existing staff and contractors retained for the transition period and costs related to integration activities. All of these employees and contractors completed their integration activities and were terminated by December 31, 2003.

*Income tax expense*

Income tax expense amounted to \$3.4 million for the nine months ended September 30, 2004, compared to \$0.1 million for the nine months ended September 30, 2003. Income tax expense has increased primarily due to expected taxes payable in the United States resulting from our increased earnings.

*Net earnings*

Our net earnings amounted to \$17.7 million, or diluted earnings per share of \$0.68, for the nine months ended September 30, 2004, compared to net earnings of \$0.3 million, or diluted earnings per share of \$0.02, for the same period of 2003. Excluding the TPC funding of \$1.1 million related to the 2003 period, the Metricom recoveries of \$0.4 million and the restructuring of \$0.3 million, our net earnings for the first nine months of 2004 were \$16.5 million, or diluted earnings per share of \$0.63. Excluding restructuring and integration costs of \$2.2 million and the Metricom recovery of \$0.5 million, our net earnings for the first nine months of 2003 were \$2.1 million, or diluted earnings per share of \$0.12.

The weighted average diluted number of shares outstanding increased to 26.1 million in 2004 due to the issuance of shares in August 2003 related to the AirPrime acquisition and to our secondary public offering in November 2003, as compared to 17.6 million in 2003.

**Contingent Liabilities**

On September 23, 2004, Sierra Wireless America, Inc., as successor to AirPrime, Inc., along with other defendants, was served with the first amended complaint of Joshua Cohen and David Beardsley on behalf of themselves and others similarly situated, which was filed in the U.S. District Court for the Central District of California for violations of federal and state securities laws allegedly occurring prior to the time AirPrime, Inc. was acquired by the Company. We have not yet been required to file our response to the first amended complaint and have given notice to our liability insurance carriers. Although there can be no assurance that an unfavourable outcome of the dispute would not have a material adverse effect on our operating results, liquidity or financial position, we are assessing the first amended complaint and believe the claims are without merit and will vigorously defend them.

During 2002, we executed a settlement agreement with Metricom, one of our U.S. customers, in a Chapter 11 reorganization under U.S. bankruptcy laws, under which all claims and counterclaims were settled. We received the amount of \$1.8 million that has been included in our net loss for 2002. We also received additional recoveries of \$0.3 million and \$0.2 million that have been included in our second and third quarter net earnings for 2003, respectively, and \$0.2 million and \$0.2 million that have been included in our first and second quarter net earnings for 2004, respectively.

Under license agreements, we are committed to royalty payments based on the sales of products using certain technologies. We recognize royalty obligations as determinable in accordance with agreement terms. Where agreements are not finalized, we have recognized our current best estimate of the obligation. When the agreements are finalized, the estimate will be revised accordingly.

We are engaged in other legal actions and believe that the ultimate outcome of these actions will not have a material adverse effect on our operating results, liquidity or financial position.

### **Critical Accounting Policies**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, and we make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent liabilities. On an on-going basis, we evaluate our estimates and judgments, including those related to revenue recognition, adequacy of allowance for doubtful accounts, adequacy of inventory reserve, income taxes and adequacy of warranty reserve. We base our estimates on historical experience and anticipated results and trends and on various other assumptions that we believe are reasonable under the circumstances. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from our estimates. Senior management has discussed with our audit committee the development, selection, and disclosure of accounting estimates used in the preparation of our consolidated financial statements.

During the quarter ended September 30, 2004, we did not adopt any new accounting policies that have a material impact on our consolidated financial statements or make changes to existing accounting policies.

The following critical accounting policies affect our more significant estimates and assumptions used in preparing our consolidated financial statements:

We recognize revenue from sales of products and services upon the later of transfer of title or upon shipment of the product to the customer or rendering of the service, so long as collectibility is reasonably assured. Customers include resellers, original equipment manufacturers, wireless service providers and end-users. We record deferred revenue when we receive cash in advance of the revenue recognition criteria being met.

A significant portion of our revenue is generated from sales to resellers. We recognize revenue on the portion of sales to certain resellers that are subject to provisions allowing various rights of return and stock rotation when the rights have expired or the products have been reported as sold by the resellers.

Funding from research and development agreements, other than government research and development arrangements, is recognized as revenue when certain criteria stipulated under the terms of those funding agreements have been met, and when there is reasonable assurance the funding will be received. Certain research and development funding will be repayable only on the occurrence of specified future events. If such events do not occur, no repayment would be required. We will recognize the liability to repay research and development funding in the period in which conditions arise that would cause research and development funding to be repayable.

We maintain an allowance for doubtful accounts for estimated losses that may arise if any of our customers are unable to make required payments. We consider the following factors when determining if collection is reasonably assured: customer credit-worthiness, past transaction history with the customer, current economic industry trends and changes in customer payment terms. If we have no previous experience with the customer, we typically obtain reports from credit organizations to ensure that the customer has a history of paying its creditors. We may also request financial information, including financial statements, to ensure that the customer has the means of making payment. If these factors indicate collection is not reasonably assured, revenue is deferred until collection becomes reasonably assured, which is generally upon receipt of cash. If the financial condition of any of our customers deteriorates, we may increase our allowance.

We value our inventory at the lower of cost, determined on a first-in-first-out basis, and estimated net realizable value. We assess the need for an inventory writedown based on our assessment of estimated market value using assumptions about future demand and market conditions. Our reserve requirements generally increase as our projected demand requirements decrease, due to market conditions, technological and product life cycle changes and longer than previously expected usage periods. If market conditions are worse than our projections, we may further writedown the value of our inventory.

We currently have intangible assets of \$14.5 million and goodwill of \$20.0 million generated from our acquisition of AirPrime in August 2003. Goodwill is tested for impairment annually, or more often, if an event or circumstance indicates that an impairment loss has been incurred.

The initial goodwill impairment test was completed during the fourth quarter of 2003, which resulted in no impairment loss. We assessed the realizability of goodwill related to our reporting unit during the fourth quarter and determined that its fair value did not have to be re-computed because the components of the reporting unit had not changed since the fair value computation completed at August 12, 2003, the date of acquisition, the previous fair value amount exceeded the carrying amount of the reporting unit by a substantial margin, and no evidence exists to indicate that the current fair value of the reporting unit would be less than its current carrying amount.

We evaluate our deferred income tax assets to assess whether their realization is more likely than not. If their realization is not considered more likely than not, we provide for a valuation allowance. The ultimate realization of our deferred tax assets is dependent upon the generation of future taxable income during the periods in which temporary differences become deductible. We consider projected future taxable income and tax planning strategies in making our assessment. If we determine that we would not be able to realize our deferred tax assets, we may make an adjustment to our deferred tax assets that would be charged to income.

We accrue product warranty costs in accrued liabilities to provide for the repair or replacement of defective products. Our accrual is based on an assessment of historical experience and management's estimates. If we suffer a decrease in the quality of our products, we may increase our accrual.

Under license agreements, we are committed to royalty payments based on the sales of products using certain technologies. We recognize royalty obligations as determinable in accordance with agreement terms. Where agreements are not finalized, we have recognized our current best estimate of the obligation in accrued liabilities. When the agreements are finalized, the estimate will be revised accordingly.

We recorded a lease provision during 2002 as a result of our restructuring program by estimating the net present value of the future cash outflows over the remaining lease period. The estimate was based on various assumptions including the obtainable sublease rates and the time it will take to find a suitable tenant. These assumptions are influenced by market conditions and the availability of similar space nearby. If market conditions change, we will adjust our provision.

We are engaged in certain legal actions and believe that the ultimate outcome of these actions will not have a material adverse effect on our operating results, liquidity or financial position. We estimate the range of liability related to pending litigation where the amount and range of loss can be reasonably estimated. We record our best estimate of a loss when the loss is considered probable. As additional information becomes available, we assess the potential liability relating to our pending litigation and revise our estimates.

## Liquidity and Capital Resources

### *Operating Activities*

Cash provided by operating activities amounted to \$21.5 million for the first nine months of 2004, compared to cash provided by operating activities of \$10.9 million in the same period of 2003, an improvement of \$10.6 million. The source of cash in 2004 primarily resulted from earnings from operations of \$22.8 million adjusted for non-cash items, inventory levels and changes in other operating assets and liabilities of \$1.3 million. Our working capital has increased significantly from December 31, 2003 as a result of strong revenue and operating expense control. Generally, our working capital requirements will increase or decrease with quarterly revenue levels.

### *Investing Activities*

Cash provided by investing activities was \$31.0 million for the nine months ended September 30, 2004, compared to cash used by investing activities of \$13.8 million during the same period in 2003. The source of cash during the first nine months of 2004 was due primarily to the disposal of long-term investments that were re-invested in investments with maturities less than 90 days. Expenditures on intangible assets were \$1.7 million in 2004, compared to \$3.9 million in 2003, and were primarily for license fees and patents. Capital expenditures were \$5.5 million in 2004, compared to \$1.0 million in 2003, and were primarily for tooling, research and development equipment, computer equipment and software.

We do not have any trading activities that involve any type of commodity contracts that are accounted for at fair value but for which a lack of market price quotations necessitate the use of fair value estimation techniques.

*Financing Activities*

Cash provided by financing activities was \$3.1 million in the first nine months of 2004, compared to a use of cash of \$1.3 million during the same period in 2003, an increase of \$4.4 million. The source of cash in 2004 was primarily from the issuance of common shares upon the exercise of stock options, offset slightly by repayments of our long-term obligations.

As of September 30, 2004, we did not have any off-balance sheet finance or special purpose entities.

*Cash Requirements*

We expect our operations will generate positive net cash during fiscal 2004.

Our near-term cash requirements are primarily related to funding our operations, capital expenditures and other obligations discussed below. We believe our cash and cash equivalents of \$125.9 million, short-term investments of \$1.6 million as of September 30, 2004 and cash generated from operations will be sufficient to fund our expected working and other capital requirements for the next twelve months based on current business plans. Our capital expenditures during 2004 are expected to be primarily for research and development equipment, tooling, licenses and patents. However, we cannot provide assurance that our actual cash requirements will not be greater than we currently expect.

The following table quantifies our future contractual obligations as of September 30, 2004:

Payments due in fiscal	Operating Leases	Obligations under Capital Leases	Total
2004	\$ 734	\$ 115	\$ 849
2005	2,638	319	2,957
2006	2,635	28	2,663
2007	2,707		2,707
2008	2,722		2,722
Thereafter	5,348		5,348
<b>Total</b>	<b>\$ 16,784</b>	<b>\$ 462</b>	<b>\$ 17,246</b>

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We have entered into purchase commitments totaling \$26.7 million with certain contract manufacturers under which we commit to buy a minimum amount of designated products. In certain of these agreements, we may be required to acquire and pay for such products up to the prescribed minimum or forecasted purchases. The terms of the commitment require us to purchase \$26.7 million of product from certain contract manufacturers between October 2004 and December 2004.

### *Sources and Uses of Cash*

In November 2003, we completed a new issue and secondary public offering in the United States and Canada. Our net proceeds after selling commissions and expenses of the offering amounted to approximately \$67.4 million. The net proceeds from the offering are to be used for product development, working capital and general corporate purposes, including acquisitions.

One of our significant sources of funds is expected to be our future operating cash flow. In the past, our revenue was dependent on us fulfilling our commitments in accordance with agreements with major customers. We have completed volume shipments on those contracts. We are now relying on purchase orders with these customers and these customers, like our other customers, will be under no contractual obligation to purchase our products. If they do not make such purchases, our future operating cash flow will be negatively impacted. We have a risk of impairment to our liquidity should there be any interruption to our business operations.



The source of funds for our future capital expenditures and commitments is cash, short-term investments, accounts receivable, research and development funding, borrowings and cash from operations, as follows:

Net cash and short-term investments amounted to \$127.5 million at September 30, 2004, compared to \$85.1 million at December 31, 2003.

Long-term investments amounted to nil at September 30, 2004, compared to \$24.6 million at December 31, 2003.

Accounts receivable amounted to \$29.7 million at September 30, 2004, compared to \$21.6 million at December 31, 2003.

We have a \$10.0 million operating line of credit with a Canadian chartered bank. The credit facility bears interest at prime plus 1.25% and is secured by a general security agreement providing a first charge against all assets. At September 30, 2004, there were no borrowings under this line of credit.

#### **Market Risk Disclosure**

During the third quarter ended September 30, 2004, 89% of our revenue was earned from United States-based customers. Our risk from currency fluctuations between the Canadian and U.S. dollar is reduced by purchasing inventory, other costs of sales and many of our services in U.S. dollars. We are exposed to foreign currency fluctuations because the majority of our research and development, sales and marketing, and administration costs are incurred in Canada. We monitor our exposure to fluctuations between the Canadian and U.S. dollars. For the three and nine months ended September 30, 2004, we have recorded a foreign exchange gain of approximately \$0.3 million and loss of \$0.3 million, respectively. As we have available funds and very little debt, we have not been adversely affected by significant interest rate fluctuations.

With our international expansion into Europe and the Asia-Pacific region, we are transacting business in additional foreign currencies and the potential for currency fluctuations is increasing. The risk associated with currency fluctuations between the U.S. dollar and foreign currencies in Europe and the Asia-Pacific region has been minimal as such transactions have not been material to date. As our business expands in Europe, we expect that we will also continue to be exposed to Euro transactions. To date we have not entered into any futures contracts. To manage our foreign currency risks, we may enter into such contracts should we consider it to be advisable to reduce our exposure to future foreign exchange fluctuations.

Currently, we do not have any hedging activities or derivative instruments, therefore the impact of FAS No. 133 is not material to our financial results.

**Related Party Transactions**

During the three and nine months ended September 30, 2004, there were no material related party transactions.

**Quarterly Results of Operations**

The following tables set forth certain unaudited consolidated statements of operations data for each of the eleven most recent quarters that, in management's opinion, have been prepared on a basis consistent with the audited consolidated financial statements contained in our fiscal 2003 Annual Report. The unaudited consolidated statements of operations data presented below reflects all adjustments, consisting primarily of normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of results for the interim periods. These operating results are not necessarily indicative of results for any future period. You should not rely on them to predict our future performance.

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2004	Quarter Ended		
	March 31	June 30	Sept. 30
Revenue	\$ 41,641	\$ 51,595	\$ 59,149
Cost of goods sold	24,839	30,680	36,107
Gross margin	16,802	20,915	23,042
Expenses:			
Sales and marketing	4,173	4,386	5,604
Research and development, net	4,739	5,991	6,566
Administration	2,064	2,534	2,354
Restructuring and other charges			289
Amortization	636	563	588
	11,612	13,474	15,401
Earnings from operations	5,190	7,441	7,641
Other income (expense)	84	(40)	694
Earnings before income taxes	5,274	7,401	8,335
Income tax expense	704	1,384	1,268
Net earnings	\$ 4,570	\$ 6,017	\$ 7,067
Earnings per share:			
Basic	\$ 0.18	\$ 0.24	\$ 0.28
Diluted	\$ 0.18	\$ 0.23	\$ 0.27
Weighted average number of shares (in thousands):			
Basic	24,986	25,221	25,301
Diluted	26,027	26,248	26,087

2003	Quarter Ended				Year 2003
	March 31	June 30	Sept. 30	Dec. 31	
Revenue	\$ 20,150	\$ 20,736	\$ 26,250	\$ 34,573	\$ 101,709
Cost of goods sold	12,210	12,405	15,566	20,370	60,551
Gross margin	7,940	8,331	10,684	14,203	41,158
Expenses:					
Sales and marketing	2,729	2,590	2,653	3,613	11,585
Research and development, net	2,749	2,947	4,677	5,621	15,994
Administration	1,617	1,451	1,331	2,198	6,597
Restructuring and other charges			1,220		1,220
Integration costs			1,026	921	1,947
Amortization	553	546	590	638	2,327
	7,648	7,534	11,497	12,991	39,670
Earnings (loss) from operations	292	797	(813)	1,212	1,488
Other income (expense)	104	167	(74)	768	965
Earnings (loss) before income taxes	396	964	(887)	1,980	2,453
Income tax expense	35	54	54	55	198
Net earnings (loss)	\$ 361	\$ 910	\$ (941)	\$ 1,925	\$ 2,255
Earnings (loss) per share:					
Basic	\$ 0.02	\$ 0.06	\$ (0.05)	\$ 0.09	\$ 0.12
Diluted	\$ 0.02	\$ 0.05	\$ (0.05)	\$ 0.08	\$ 0.12
Weighted average number of shares (in thousands):					
Basic	16,355	16,375	18,409	22,563	18,442

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Diluted	16,718	16,754	18,409	23,383	18,989
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2002	Quarter Ended				Year 2002
	March 31	June 30	Sept. 30	Dec. 31	
Revenue	\$ 16,700	\$ 16,929	\$ 21,083	\$ 22,547	\$ 77,259
Cost of goods sold	10,780	29,677	12,817	15,987	69,261
Gross margin	5,920	(12,748)	8,266	6,560	7,998
Expenses:					
Sales and marketing	2,710	2,920	2,801	3,133	11,564
Research and development, net	4,801	4,615	3,217	2,263	14,896
Administration	1,973	1,837	1,331	(356)	4,785
Restructuring and other charges		13,093		(224)	12,869
Amortization	653	594	529	555	2,331
	10,137	23,059	7,878	5,371	46,445
Earnings (loss) from operations	(4,217)	(35,807)	388	1,189	(38,447)
Other income (expense)	(122)	96	124	149	247
Earnings (loss) before income taxes	(4,339)	(35,711)	512	1,338	(38,200)
Income tax expense		3,424	9	30	3,463
Net earnings (loss)	\$ (4,339)	\$ (39,135)	\$ 503	\$ 1,308	\$ (41,663)
Earnings (loss) per share:					
Basic	\$ (0.27)	\$ (2.40)	\$ 0.03	\$ 0.08	\$ (2.56)
Diluted	\$ (0.27)	\$ (2.40)	\$ 0.03	\$ 0.08	\$ (2.56)
Weighted average number of shares (in thousands):					
Basic	16,263	16,305	16,314	16,334	16,304
Diluted	16,263	16,305	16,539	16,733	16,304

**Selected Annual Information**

Years ended December 31,	2001	2002	2003
Revenue	\$ 62,348	\$ 77,259	\$ 101,709
Net earnings (loss)	(24,269)	(41,663)	2,255
Diluted earnings (loss) per share	(1.50)	(2.56)	0.12
Total assets	110,724	71,089	175,868
Total long-term liabilities	2,720	6,590	3,735

**Differences Between United States and Canadian GAAP**

The MD&A has been prepared in accordance with U.S. GAAP. Differences between our consolidated financial statements under U.S. GAAP and our consolidated financial statements under Canadian GAAP reflect differences in accounting for employee stock compensation and exchange rates used to translate prior years' assets, liabilities, revenue, and expenses on adopting the U.S. dollar as our primary currency for measurement and display during the year ended December 31, 1999.

Cost of goods sold, sales and marketing expense, research and development expense, administration expense, deficit, contributed surplus and share capital for the three and nine months ended September 30, 2004 were different under Canadian GAAP due to the retroactive adoption on January 1, 2004 of the new recommendations of the Canadian Institute of Chartered Accountants related to stock-based compensation. The

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amended standard requires recognition of an estimate of the fair value of employee stock-based awards in earnings. Under the amended standard, compensation expense is recorded and contributed surplus and share capital are increased to reflect the fair values of the unexercised and exercised stock options, respectively. Under U.S. GAAP, only note disclosure is required for the pro forma net income using a fair value based method for employee stock-based awards. The impact of the retroactive application of the recommendations on our net earnings under Canadian GAAP for the three and nine months ended September 30, 2004 was a reduction of \$1,331 (2003 - \$1,333) and \$4,227 (2003 - \$13,438), respectively, and a reduction of our diluted earnings per share of \$0.05 (2003 - \$0.07) and \$0.16 (2003 - \$0.78), respectively. At December 31, 2003, the restatement resulted in an increase in our deficit of \$39,004 (2002 - \$24,229).

## **Forward-looking Statements**

This report contains forward-looking statements that involve risks and uncertainties. These forward-looking statements relate to, among other things, plans and timing for the introduction or enhancement of our services and products, statements about future market conditions, supply and demand conditions, channel inventory and sell through, revenue, gross margin, operating expenses, profits, and other expectations, intentions and plans contained in this report that are not historical fact. Our expectations regarding future revenues and earnings depend in part upon our ability to develop, manufacture, supply and market products that we do not produce today and that meet defined specifications. When used in this report, the words "plan", "expect", "believe", and similar expressions generally identify forward-looking statements. These statements reflect our current expectations. They are subject to a number of risks and uncertainties, including but not limited to, changes in technology and changes in the wireless communications market. In light of the many risks and uncertainties surrounding the wireless communications market, you should understand that we cannot assure you that the forward-looking statements contained in this report will be realized.

## **Risk Factors**

Our business is subject to significant risks and past performance is no guarantee of future performance. Some of the risks we face are:

### **We have incurred net losses in the past and may not sustain profitability.**

While we had earnings from operations for the year ended December 31, 2003, we have incurred a loss from operations in each of the previous three fiscal years. As of September 30, 2004 our accumulated deficit was \$53.7 million. While we had net earnings of \$17.7 million for the nine months ended September 30, 2004, our ability to achieve and maintain profitability will depend on, among other things, the continued sales of our products and the successful development and commercialization of new products. We cannot predict if the current profitability will be sustainable on a quarterly or an annual basis. As a result, our share price may decline.

If the current profitability does not continue, we may need to raise additional capital in the future. Additional financing may not be available, and even if available, may not be on acceptable terms. We may seek to raise additional capital through an offering of common shares, preference shares or debt, which may result in dilution, and/or the issuance of securities with rights senior to the rights, of the holders of common shares.

### **If demand for our current products declines and we are unable to launch successful new products, our revenues will decrease.**

If the markets in which we compete fail to grow, or grow more slowly than we currently anticipate, or if we are unable to establish markets for our new products, it would significantly harm our business, results of operations and financial condition. In addition, demand for one or all of our current products could decline as a result of competition, technological change or other factors.

### **If we are unable to design and develop new products that gain sufficient commercial acceptance, we may be unable to maintain our market share or to recover our research and development expenses and our revenues could decline.**

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We depend on designing, developing and marketing new products to achieve much of our future growth. Our ability to design, develop and market new products depends on a number of factors, including, but not limited to the following:

Our ability to attract and retain skilled technical employees;

The availability of critical components from third parties;

Our ability to successfully complete the development of products in a timely manner; and

Our ability to manufacture products at an acceptable price and quality.

A failure by us, or our suppliers, in any of these areas, or a failure of new products, such as the Voq professional phone, to obtain commercial acceptance, could mean we receive less revenue than we anticipate and we are unable to recover our research and development expenses, and could result in a decrease in the market price for our shares.



**The loss of any of our material customers could adversely affect our revenue and profitability, and therefore shareholder value.**

We depend on a small number of customers for a significant portion of our revenues. In the last two fiscal years, there have been two different customers that individually accounted for more than 10% of our revenues. In the nine months ended September 30, 2004, two customers individually accounted for more than 10% of our revenue and in aggregate these two customers represented 51% of our revenue. If any of these customers reduce their business with us or suffer from business failure, our revenues and profitability could decline, perhaps materially.

**We may not be able to continue to design products that meet our customer needs and, as a result, our revenue and profitability may decrease.**

We develop products to meet our customers' requirements but, particularly with original equipment manufacturers, current design wins do not guarantee future design wins. If we are unable or choose not to meet our customers' future needs, we may not win their future business and our revenue and profitability may decrease.

**We depend on a few third parties to manufacture our products and supply key components. If they do not manufacture our products properly or cannot meet our needs in a timely manner, we may be unable to fulfill our product delivery obligations and our costs may increase, and our revenue and margins could decrease.**

We outsource a substantial part of the manufacture of our products to third parties and depend heavily on the ability of these manufacturers to meet our needs in a timely and satisfactory manner. Some components used by us may only be available from a small number of suppliers, in some cases from only one supplier. We currently rely on three manufacturers, any of which may terminate the manufacturing contract with us at the end of any contract year. Our reliance on third party manufacturers and suppliers subjects us to a number of risks, including the following:

The absence of guaranteed manufacturing capacity;

Reduced control over delivery schedules, production yields and costs; and

Inability to control the amount of time and resources devoted to the manufacture of our products.

If we are unable to successfully manage any of these risks or to locate alternative or additional manufacturers or suppliers in a timely and cost-effective manner, we may not be able to deliver products in a timely manner. In addition, our results of operations could be harmed by increased costs, reduced revenues and reduced margins.

**We do not have fixed-term employment agreements with our key personnel and the loss of any key personnel may harm our ability to compete effectively.**

None of our officers or other key employees has entered into a fixed-term employment agreement. Our success depends in large part on the abilities and experience of our executive officers and other key employees. Competition for highly skilled management, technical, research and development and other key employees is intense in the wireless communications industry. We may not be able to retain our current key employees or attract and retain additional key employees as needed. The loss of key employees could disrupt our operations and impair our ability to compete effectively.

**We may have difficulty responding to changing technology, industry standards and customer preferences, which could cause us to be unable to recover our research and development expenses and lose revenues.**

The wireless industry is characterized by rapid technological change. Our success will depend in part on our ability to develop products that keep pace with the continuing changes in technology, evolving industry standards and changing customer and end-user preferences and requirements. Our products embody complex technology that may not meet those standards, changes and preferences. In addition, wireless communications service providers require that wireless data systems deployed on their networks comply with their own standards, which may differ from the standards of other providers. We may be unable to successfully address these developments in a timely basis or at all. Our failure to respond quickly and cost-effectively to new developments through the development of new products or enhancements to existing products could cause us to be unable to recover significant research and development expenses and reduce our revenues.

**Competition from new or established wireless communication companies or from those with greater resources may prevent us from increasing or maintaining our market share and could result in price reductions and reduced revenues.**

The wireless industry is intensely competitive and subject to rapid technological change. We expect competition to intensify. More established and larger companies with greater financial, technical and marketing resources sell products that compete with ours. We also may introduce new products that will put us in direct competition with major new competitors. Existing or future competitors may be able to respond more quickly to technological developments and changes or may independently develop and patent technologies and products that are superior to ours or achieve greater acceptance due to factors such as more favorable pricing or more efficient sales channels. If we are unable to compete effectively with our competitors pricing strategies, technological advances and other initiatives, our market share and revenues may be reduced.

**We depend on third parties to offer wireless data and voice communications services for our products to operate.**

Our products can only be used over wireless data and voice networks operated by third parties. In addition, our future growth depends, in part, on the successful deployment of next generation wireless data and voice networks by third parties for which we are developing products. If these network operators cease to offer effective and reliable service, or fail to market their services effectively, sales of our products will decline and our revenues will decrease.

**Acquisitions of companies or technologies may result in disruptions to our business or may not achieve the anticipated benefits.**

As part of our business strategy, we may acquire additional assets and businesses principally relating to or complementary to our current operations. Any acquisitions and/or mergers by us will be accompanied by the risks commonly encountered in acquisitions of companies. These risks include, among other things:

Exposure to unknown liabilities of acquired companies, including unknown litigation related to acts or omissions of our acquired company and/or its directors and officers prior to the acquisition;

Higher than anticipated acquisition costs and expenses;

Effects of costs and expenses of acquiring and integrating new businesses on our operating results and financial condition;

The difficulty and expense of integrating the operations and personnel of the companies;

Disruption of our ongoing business;

Diversion of management's time and attention away from our remaining business during the integration process;

Failure to maximize our financial and strategic position by the successful incorporation of acquired technology;

The inability to implement uniform standards, controls, procedures and policies;

The loss of key employees and customers as a result of changes in management;

The incurrence of amortization expenses; and

Possible dilution to our shareholders.

In addition, geographic distances may make integration of businesses more difficult. We may not be successful in overcoming these risks or any other problems encountered in connection with any acquisitions. If realized, these risks could reduce shareholder value.

**Others could claim that we infringe on their intellectual property rights, which may result in substantial costs, diversion of resources and management attention and harm to our reputation.**

It is possible that other parties may claim that we have violated their intellectual property rights. Rights to intellectual property can be difficult to verify. Competitors could assert, for example, that former employees of theirs whom we have hired have misappropriated their proprietary information for our benefit. A successful infringement claim against us could damage us in the following ways:

We may be liable for damages and litigation costs, including attorneys' fees;

We may be prohibited from further use of the intellectual property;

We may have to license the intellectual property, incurring licensing fees; and

We may have to develop a non-infringing alternative, which could be costly and delay or result in the loss of sales.

Regardless of the outcome, an infringement claim could result in substantial costs, diversion of resources and management attention and harm to our reputation.

**If we are successful in the design and development of our new products, and there is commercial acceptance of our products, such as the Voq professional phone, others may claim that we infringe on their intellectual property rights, which may result in substantial costs, diversion of resources and management attention and harm our reputation.**

**Misappropriation of our intellectual property could place us at a competitive disadvantage.**

Our intellectual property is important to our success. We rely on a combination of patent protection, copyrights, trademarks, trade secrets, licenses, non-disclosure agreements and other contractual agreements to protect our intellectual property. Third parties may attempt to copy aspects of our products and technology or obtain information we regard as proprietary without our authorization. If we are unable to protect our intellectual property against unauthorized use by others it could have an adverse effect on our competitive position.

Our strategies to deter misappropriation could be inadequate due to the following risks:

Non-recognition of the proprietary nature or inadequate protection of our methodologies in the United States, Canada or foreign countries;

Undetected misappropriation of our intellectual property;

The substantial legal and other costs of protecting and enforcing our rights in our intellectual property; and

Development of similar technologies by our competitors.

In addition, we could be required to spend significant funds and our managerial resources could be diverted in order to defend our rights, which could disrupt our operations.

**As our business expands internationally, we will be exposed to additional risks relating to international operations.**

Our expansion into international operations exposes us to additional risks unique to such international markets, including the following:

Increased credit management risks and greater difficulties in collecting accounts receivable;

Unexpected changes in regulatory requirements, wireless communications standards, exchange rates, trading policies, tariffs and other barriers;

Uncertainties of laws and enforcement relating to the protection of intellectual property;

Language barriers; and

Potential adverse tax consequences.

Furthermore, if we are unable to further develop distribution channels in Europe and the Asia-Pacific region we may not be able to grow our international operations and our ability to increase our revenue will be negatively impacted.

**Government regulation could result in increased costs and inability to sell our products.**

Our products are subject to certain mandatory regulatory approvals in the United States, Canada and other countries in which we operate. In the United States, the Federal Communications Commission regulates many aspects of communications devices. In Canada, similar regulations are administered by the Ministry of Industry, through Industry Canada. Although we have obtained all the necessary Federal Communications Commission, Industry Canada and other required approvals for the products we currently sell, we may not obtain approvals for future products on a timely basis, or at all. In addition, regulatory requirements may change or we may not be able to obtain regulatory approvals from countries other than the United States and Canada in which we may desire to sell products in the future.



**Fluctuations in exchange rates between the United States dollar and the Canadian dollar may affect our operating results.**

We are exposed to fluctuations in the exchange rate between the United States dollar and the Canadian dollar through our operations in Canada. To reduce our risk because of currency fluctuations, we purchase inventory, other cost of sales items and many of our services in United States dollars. If the Canadian dollar rises relative to the United States dollar, our operating results may be negatively impacted. To date, we have not entered into any foreign currency futures contracts as part of a hedging policy, but we have purchased Canadian currency to cover our Canadian currency requirements for the next fiscal quarter. We have entered into distribution agreements in Europe and the Asia-Pacific region that are denominated primarily in U.S. dollars. We expect that as our business expands in Europe and the Asia-Pacific region, we will also be exposed to additional foreign currency transactions and to the associated currency risk. To date, we have not entered into any futures contracts.



## SIERRA WIRELESS, INC.

## Consolidated Statements of Operations

(Expressed in thousands of United States dollars, except per share amounts)

(Prepared in accordance with Canadian generally accepted accounting principles (GAAP))

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2004	2003	2004	2003
		(Restated Note 2)		(Restated Note 2)
Revenue	\$ 59,149	\$ 26,250	\$ 152,385	\$ 67,136
Cost of goods sold	36,191	15,619	91,872	40,767
Gross margin	22,958	10,631	60,513	26,369
Expenses				
Sales and marketing	6,006	2,929	15,382	12,420
Research and development, net	6,963	5,170	18,679	15,449
Administration	2,802	1,860	8,331	7,745
Restructuring and other charges (note 3)	289	930	289	930
Integration costs (note 4)		1,026		1,026
Amortization	588	590	1,787	1,689
	16,648	12,505	44,468	39,259
Earnings (loss) from operations	6,310	(1,874)	16,045	(12,890)
Other income (expense)	694	(74)	738	197
Earnings (loss) before income taxes	7,004	(1,948)	16,783	(12,693)
Income tax expense	1,268	54	3,356	143
Net earnings (loss)	\$ 5,736	\$ (2,002)	\$ 13,427	\$ (12,836)
Earnings (loss) per share for the period:				
Basic	\$ 0.23	\$ (0.11)	\$ 0.53	\$ (0.75)
Diluted	\$ 0.22	\$ (0.11)	\$ 0.52	\$ (0.75)
Weighted average number of shares (in thousands)				
Basic	25,301	18,409	25,170	17,054
Diluted	25,893	18,409	25,900	17,054

See accompanying notes to consolidated financial statements.

## SIERRA WIRELESS, INC.

## Consolidated Statements of Deficit

(Expressed in thousands of United States dollars)

(Prepared in accordance with Canadian GAAP)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003 (Restated Note 2)	2004	2003 (Restated Note 2)
Deficit, beginning of period as previously reported	\$ (101,644)	\$ (71,315)	\$ (70,331)	\$ (72,586)
Adjustment to reflect change in accounting for employee stock options (note 2)		(36,334)	(39,004)	(24,229)
Deficit, beginning of period as restated	(101,644)	(107,649)	(109,335)	(96,815)
Net earnings (loss)	5,736	(2,002)	13,427	(12,836)
Deficit, end of period	\$ (95,908)	\$ (109,651)	\$ (95,908)	\$ (109,651)

See accompanying notes to consolidated financial statements.

## SIERRA WIRELESS, INC.

## Consolidated Balance Sheets

(Expressed in thousands of United States dollars)

(Prepared in accordance with Canadian States GAAP)

	September 30, 2004 (Unaudited)	December 31, 2003 (Restated Note 2)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 125,939	\$ 70,358
Short-term investments (note 5)	1,587	14,760
Accounts receivable	29,717	21,566
Inventories	8,615	1,511
Prepaid expenses	4,152	2,223
	170,010	110,418
Long-term investments (note 5)		
		24,639
Capital assets	9,246	5,985
Intangible assets	14,458	14,620
Goodwill	19,967	19,706
Future income taxes	500	500
Other assets	1,726	
	\$ 215,907	\$ 175,868
<b>Liabilities and Shareholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 10,862	\$ 5,966
Accrued liabilities	35,651	22,221
Deferred revenue and credits	330	399
Current portion of long-term liabilities	1,033	1,328
Current portion of obligations under capital lease	482	141
	48,358	30,055
Long-term liabilities		
Obligations under capital lease	1,700	2,266
	216	
Shareholders equity:		
Share capital (note 6)	220,837	213,964
Warrants	1,538	1,538
Contributed surplus	39,650	37,864
Deficit	(95,908)	(109,335)
Cumulative translation adjustments	(484)	(484)
	165,633	143,547
	\$ 215,907	\$ 175,868

Contingencies (note 7)

See accompanying notes to consolidated financial statements.

## SIERRA WIRELESS, INC.

## Consolidated Statements of Cash Flows

(Expressed in thousands of United States dollars)

(Prepared in accordance with Canadian GAAP)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003 (Restated Note 2)	2004	2003 (Restated Note 2)
Cash flows from operating activities:				
Net earnings (loss) for the period	\$ 5,736	\$ (2,002)	\$ 13,427	\$ (12,836)
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities				
Amortization	1,810	1,690	4,978	4,411
Non-cash restructuring and other charges	289	605	289	605
Stock-based employee compensation (note 2)	1,331	1,333	4,227	13,438
Loss (gain) on disposal	(62)		(67)	2
Accrued warrants				329
Changes in operating assets and liabilities				
Accounts receivable	(1,114)	(453)	(8,551)	(2,537)
Inventories	(5,680)	2,146	(7,104)	4,460
Prepaid expenses	(142)	167	(3,655)	288
Accounts payable	5,025	(6,432)	4,896	(4,051)
Accrued liabilities	696	6,873	13,169	6,691
Deferred revenue and credits	158	201	(69)	132
Net cash provided by operating activities	8,047	4,128	21,540	10,932
Cash flows from investing activities:				
Business acquisitions		666		(126)
Proceeds on disposal	62		67	4
Purchase of capital assets	(2,002)	(618)	(5,536)	(975)
Increase in intangible assets	(85)	(2,614)	(1,682)	(3,928)
Purchase of long-term investments			(21,369)	
Proceeds on disposal of long-term investments			46,186	
Purchase of short-term investments	(95)	52	(21,254)	(10,170)
Proceeds on maturity of short-term investments	14,200	1,417	34,564	1,417
Net cash provided by (used in) investing activities	12,080	(1,097)	30,976	(13,778)

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Cash flows from financing activities:							
Issue of common shares	217		319		4,432		360
Repayment of long-term liabilities	(537)		(507)		(1,367)		(1,665)
Net cash provided by (used in) financing activities	(320)		(188)		3,065		(1,305)
Net increase (decrease) in cash and cash equivalents							
	19,807		2,843		55,581		(4,151)
Cash and cash equivalents, beginning of period	106,132		27,847		70,358		34,841
Cash and cash equivalents, end of period	\$ 125,939	\$	30,690	\$	125,939	\$	30,690

See supplementary information (note 8).

See accompanying notes to consolidated financial statements.

**SIERRA WIRELESS, INC.**

**Notes to Consolidated Financial Statements**

(Expressed in thousands of United States dollars, except per share amounts and number of shares)

(Prepared in accordance with Canadian GAAP)

(Unaudited)

**1. Basis of presentation**

The accompanying interim financial information does not include all disclosures required under Canadian generally accepted accounting principles for annual financial statements. The accompanying financial information is unaudited and reflects all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of results for the interim periods. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our fiscal 2003 Annual Report.

**2. Significant accounting policies**

These interim financial statements follow the same accounting policies and methods of application as our annual financial statements, except for 2(b).

*(a) Principles of consolidation*

Our consolidated financial statements include the accounts of Sierra Wireless, Inc. and its wholly-owned subsidiaries Sierra Wireless Data, Inc., Sierra Wireless America, Inc. (formerly AirPrime, Inc.), Sierra Wireless (UK) Limited, Sierra Wireless (Asia Pacific) Limited, Sierra Wireless SRL and Sierra Wireless ULC from their respective dates of formation or acquisition. We have eliminated all significant intercompany balances and transactions.

*(b) Stock-based compensation*

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Prior to January 1, 2004, we accounted for employee stock options using the intrinsic value method. Accordingly, no stock-based compensation cost was recognized as all options were granted with an exercise price equal to the market value of the underlying common shares on the date of grant. Previously, we provided note disclosure of pro forma net earnings (loss) as if the fair value based method had been used.

Effective January 1, 2004, we adopted the fair value recognition provisions of the amended Canadian Institute of Chartered Accountants Handbook ( HB ) 3870, Stock-based Compensation and Other Stock-based Payments ( HB 3870 ), which requires recognition of an estimate of the fair value of stock-based awards in earnings. We have retroactively applied HB 3870, with restatement of prior periods to record the compensation cost that would have been recognized had the fair value recognition provisions of HB 3870 been applied to all awards granted to employees since the inception of the stock option plan in 1997.

We have accounted for employee stock-based compensation using the fair value recognition provisions of HB 3870 and the Black-Scholes option-pricing model. The restatement at December 31, 2003 resulted in an increase in the deficit of \$39,004 (December 31, 2002 - \$24,229), an increase in contributed surplus of \$37,864 and an increase in share capital of \$1,140. The change in accounting policy results in compensation expense related to employee stock options of \$1,331 and \$4,227 for the three and nine months ended September 30, 2004, respectively, and \$1,333 and \$13,438 for the three and nine months ended September 30, 2003, respectively.

### **3. Restructuring and other charges**

In the third quarter of 2004, we recorded an additional facilities restructuring charge of \$289 related to a change in estimate of the future operating expenses and the foreign exchange loss on the Canadian dollar denominated liability.

In the third quarter of 2003, we incurred restructuring and other charges of \$930 as a result of our acquisition of AirPrime.

The following table summarizes the changes in the provision for restructuring and other charges for the nine months ended September 30, 2004 and the balance of the provision at September 30, 2004.



	Facilities Restructuring	Other	Total
Balance at December 31, 2003	\$3,594	\$77	\$3,671
Additional charges	289		289
Cash payments	(1,150)	(24)	(1,174)
Balance at September 30, 2004	\$2,733	\$53	\$2,786

#### 4. Integration costs

In the third quarter of 2003, we also incurred integration costs related to the AirPrime acquisition of \$1,026, which included the costs of 13 existing employees retained for the transition period. All of these employees completed their integration activities and were terminated by December 31, 2003.

#### 5. Investments

Investments, all of which are classified as available-for-sale, were comprised as follows:

	Short-term		Long-term	
	September 30, 2004	December 31, 2003	September 30, 2004	December 31, 2003
Government treasury bills	\$ 1,587	\$ 11,827	\$	\$
Bankers acceptances		1,937		
Commercial paper		996		
Government bonds				24,639
	\$ 1,587	\$ 14,760	\$	\$ 24,639

Our short-term investments all have contractual maturities of less than one year.

During the second quarter of 2004, we liquidated our bond portfolio and no significant gain or loss was realized. At September 30, 2004 there were no significant unrealized holding gains or losses on available-for-sale securities.

#### 6. Share capital

Changes in the issued and outstanding common shares are as follows:

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	Number of Shares	Amount
Balance at December 31, 2003	24,822,071	\$ 213,964
Stock option exercises for the quarter ended March 31, 2004	335,835	4,857
Balance at March 31, 2004	25,157,906	218,821
Stock option exercises for the quarter ended June 30, 2004	123,839	1,647
Balance at June 30, 2004	25,281,745	220,468
Stock option exercises for the quarter ended September 30, 2004	44,480	369
Balance at September 30, 2004	25,326,225	\$ 220,837

The fair value of stock options exercised increased share capital by \$152 and \$2,441 for the three and nine months ended September 30, 2004, respectively.

*Stock option plan*

In accordance with HB 3870, we record compensation expense in the statements of operations by recognizing the calculated benefit at the date of granting the stock options on a straight-line basis over the vesting period. We have estimated the fair value of each option on the date of the grant using the Black-Scholes option-pricing model with the following assumptions:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Expected dividend yield				
Expected stock price volatility	86%	102%	95%	103%
Risk-free interest rate	3.84%	3.77%	3.64%	3.82%
Expected life of options	4 years	4 years	4 years	4 years
Weighted average fair value of options granted	\$ 11.91	\$ 6.14	\$ 16.80	\$ 5.23

As a result of our 2003 voluntary option surrender initiative, the unrecognized stock compensation cost of \$7,301 related to the surrendered options was expensed in the second quarter of 2003.

The following table summarizes the stock options outstanding as at September 30, 2004:

Range of Exercise Prices	Number of Shares In years	Options Outstanding		Options Exercisable			
		Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	Cdn.\$	U.S.\$
			Cdn.\$	U.S.\$		Cdn.\$	U.S.\$
\$ 0.71 \$1.19 (Cdn.\$0.90 Cdn.\$1.50)	33,164	3.0	\$ 1.30	\$ 1.03	33,164	\$ 1.30	\$ 1.03
\$ 1.20 \$2.78 (Cdn.\$1.51 Cdn.\$3.50)	327,779	2.9	3.35	2.66	138,239	3.29	2.61
\$ 2.79 \$9.52 (Cdn.\$3.51 Cdn.\$12.00)	283,225	3.8	9.44	7.50	82,923	8.81	6.99
\$ 9.53 \$15.87 (Cdn.\$12.01 Cdn.\$20.00)	135,009	2.9	16.40	13.01	58,719	15.40	12.22
\$ 15.88 \$23.81 (Cdn.\$20.01 Cdn.\$30.00)	469,667	3.9	22.14	17.57	74,160	24.29	19.28
\$ 23.82 \$139.72 (Cdn.\$30.01 Cdn.\$176.05)	462,080	3.9	41.55	32.98	58,215	91.77	72.83
	1,710,924	3.6	16.53	10.35	445,420	20.82	16.53

The options outstanding at September 30, 2004 expire between November 2004 and September 2009.

## 7. Contingencies

### (a) Contingent liability on sale of products

(i) Under license agreements, we are committed to royalty payments based on the sales of products using certain technologies. We recognize royalty obligations as determinable in accordance with agreement terms. Where agreements are not finalized, we have recognized our current best estimate of the obligation. When the agreements are finalized, the estimate will be revised accordingly.

(ii) Under certain research and development funding agreements, we are contingently liable to repay up to \$3,262. Repayment for certain of the research and development funding agreements is contingent upon reaching certain revenue levels for specified products.

(iii) Under an agreement with the Government of Canada's Technology Partnerships Canada ( TPC ) program, we have received Cdn. \$9,999 to support the development of a range of third generation wireless technologies. Under the terms of the agreement, an amount up to a maximum of Cdn. \$13,000 is to be repaid based on annual sales, in excess of certain minimum amounts, of specified products commencing in 2004. During the nine months ended September 30, 2004, we claimed nil (2003 \$482) that has been recorded as a reduction of research and development expense. During the three and nine months ended September 30, 2004, we have recorded, in research and development expense, the repayment of \$544 and \$1,371, respectively. In addition, we issued warrants to TPC to purchase 138,696 common shares on December 30, 2003, valued at Cdn. \$2,000 based on the Black-Scholes pricing model. The warrants are exercisable at Cdn \$20.49 per share for a term of five years from December 30, 2003. As of September 30, 2004 no warrants have been exercised.

In March 2004, we entered into a second agreement with TPC under which we are eligible to receive conditionally repayable research and development funding up to Cdn. \$9,540 to support the development of a range of third generation wireless technologies. The agreement is effective April 2003. During the three and nine months ended September 30, 2004, we have claimed \$380 and \$2,170, respectively, which has been recorded as a reduction of research and development expense. Under the terms of the agreement, repayment based on a percentage of annual sales, in excess of certain minimum amounts, will be made over the period from April 2003 to December 2011. If the payments during this period are less than Cdn. \$16,455, payments will continue subsequent to December 2011 until the earlier of when the amount is reached or December 2014.

(iv) We accrue product warranty costs, when we sell the related products, to provide for the repair or replacement of defective products. Our accrual is based on an assessment of historical experience and on management's estimates. An analysis of changes in the liability for product warranties follows:

Balance at December 31, 2003	\$	2,341
Provisions		380
Expenditures		(267)
Balance at March 31, 2004		2,454
Provisions		631
Expenditures		(220)
Balance at June 30, 2004		2,865
Provisions		973
Expenditures		(822)
Balance at September 30, 2004	\$	3,016

**(b) Other commitments**

We have entered into purchase commitments totaling \$26,651 with certain contract manufacturers under which we commit to buy a minimum amount of designated products between October 2004 and December 2004. In certain of these agreements, we may be required to acquire and pay for such products up to the prescribed minimum or forecasted purchases.

**(c) Legal proceedings**

We are engaged in certain legal actions and believe that the ultimate outcome of these actions will not have a material adverse effect on our operating results, liquidity or financial position.

**8. Supplementary information**

Three months ended September 30,		Nine months ended September 30,	
2004	2003	2004	2003

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Cash received for				
Interest	\$	381	\$	95
			\$	1,144
			\$	259
Income taxes				
				4
				4
Cash paid for				
Interest		12		12
Income taxes		24		272
				62
Non-cash financing activities				
Purchase of capital assets funded by obligations under capital lease				
		161		774
				113
Issuance of common shares on acquisition (note 3)				
			22,377	22,377

**9. Comparative figures**

We have reclassified certain of the figures presented for comparative purposes to conform to the financial statement presentation we adopted for the current period.