

NIGHTHAWK SYSTEMS INC  
Form 10KSB  
April 15, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-KSB**

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ý ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NO. 0-30786

**NIGHTHAWK SYSTEMS, INC.**  
(Exact name of registrant as specified in its charter)

**NEVADA**

(State or other jurisdiction of  
incorporation or organization)

**87-0627349**

(IRS Employer Identification No.)

**10715 GULFDAL, STE 200**

**SAN ANTONIO, TEXAS 78216**

**(210) 341-4811**

(Address, including zip code, and telephone number, including  
area code, of registrant's principal executive offices)

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: COMMON STOCK, \$0.001 PAR  
VALUE

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Registrant's revenues for its most recent fiscal year were \$1,655,098.

The aggregate market value of the voting and non-voting common equity held by non-affiliates based on the closing price on April 14, 2008 was \$6,721,653.

As of April 14, 2008 there were 134,433,060 shares of common stock, par value \$.001 per share, of the registrant issued and outstanding.

Transitional Small Business Disclosure Format Used (Check one): Yes ☐ No ☒

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## PART I

### ITEM 1. DESCRIPTION OF BUSINESS

#### GENERAL

Nighthawk Systems, Inc. ( Nighthawk or the Company , we , us or our ) is a provider of intelligent wireless power control and emergency notification products that enable the immediate and simultaneous remote activation or deactivation of equipment or display of messages, on demand. We save our customers time, effort and money by extending their reach, giving them the ability to wirelessly access and control assets and systems that may be widely dispersed or remotely located, eliminating the cost and inconvenience of sending personnel to manually perform tasks that are often unscheduled. These inexpensive and reliable products are shipped fully programmed and are ready and easy to use. Nighthawk has been selling its telemetry products to a national customer base for more than seven years.

Our power control products automate the manual process of pushing a power button, flipping a switch or plugging in/unplugging an electrical cord. A wireless signal is sent to the Nighthawk unit, which turns on or off the item or starts or stops the process, much like a household garage door opener is used. However, Nighthawk units utilize existing public and private wireless networks that cover well over 90% of the United States. The command codes can be easily generated from any telephone (landline or cellular), or via the Internet, so Nighthawk units can be placed and accessed from almost anywhere.

There is an abundance of wireline and wireless monitoring services available to companies and consumers today. Information supplied by these services typically notifies the user that something needs to be done, though the timing of that notification and the resultant required task often cannot be predicted. Nighthawk technology allows customers to avoid the time, expense and inconvenience of sending vehicles and personnel to offsite locations to perform tasks that can now be performed remotely. Nighthawk devices also lower exposure to liability claims from accidents that often occur while manually performing tasks that could otherwise be automated using Nighthawk devices.

Nighthawk power control products are intelligent through the use of proprietary firmware, several functions can be carried out by multiple units by sending a single, short digital message. For example, a single message could be utilized to contact multiple units across the United States, instructing those units to turn on and off at various intervals, several times per day. This eliminates the need to stay in constant contact with a Nighthawk device. Nighthawk technology also enables messages to be sent wirelessly to multiple alarms and signs or printers to print or display custom messages associated with particular events. As such, Nighthawk units are a perfect fit for public or emergency notification applications.

On October 11, 2007, the Company acquired the assets and assumed certain liabilities of the Set-Top Box ( STB ) business of Eagle Broadband, Inc. ( Eagle Broadband ) for \$4,750,000 in cash. The assets acquired included all accounts receivable, inventory, fixed assets and intangibles. This acquisition was funded by a \$6.0 million sale of Series B Convertible Preferred Stock and warrants to Dutchess Private Equities Fund Ltd. ( Dutchess ). The Set-Top Box business designs, manufactures and markets its proprietary MediaPro IP set-top boxes. Either standalone or in conjunction with various third-party middleware software, the MediaPro set-top boxes deliver a full range of high quality, standard and high definition entertainment and information services, including IPTV and Video on Demand services, that can generate revenues for telecom service providers and the hospitality industry.

At the time of the acquisition, STB had a backlog of orders for 2,050 units from a hospitality services integrator. These orders were placed with Eagle Broadband in conjunction with a purchase agreement that had been executed between Eagle Broadband and the customer. While the customer was not obligated to make any purchases under the agreement, the agreement provided a pricing schedule for future purchases based on the customers stated need for up to 30,000 total units. This acquisition was made primarily in an effort to enhance the future cash flows of the Company based on potential inflows from the STB business, and to reduce or eliminate monthly operating cash flow deficits. Although no assurance may be given that it will be able to do so, Company management believes that this operation may be able to generate sufficient cash flows at some point during 2008 to cover the Company's overall operating cash flow requirements, and eliminate the requirement for additional funding from third parties.

Nighthawk currently has customers in 46 states, as well as several foreign countries. Customers include, but are not limited to, more than fifty electric utilities, as well as state departments of transportation, state and municipal agencies, fire departments, wireless communications companies, digital display companies and traffic control equipment providers. Nighthawk's customer base includes many fortune 500 enterprise accounts.

## **BACKGROUND**

Nighthawk was formed from the 2002 merger of Peregrine Control Technologies, Inc. ( PCT , a private Colorado company) and LSI Communications (a Nevada public shell). PCT, a paging repair company, recognized an opportunity in 1999 to supplement declining demand for its services by manufacturing control products that utilized paging technology to wirelessly control electrical appliances.

Since that time, Nighthawk has evolved from a custom job shop to a Company capable of developing, manufacturing and selling wireless telemetry solutions on a large scale basis to growing markets. Today, with a team of 11 employees, Nighthawk designs, builds and markets intelligent power control and emergency notification products that are inexpensive, reliable and can remotely control almost any device from almost any location. Its proprietary wireless products offer customers many compelling features and functionality.

## **NIGHTHAWK TECHNOLOGY**

### **POWER CONTROL PRODUCTS**

Nighthawk has designed and developed the PT1000, its own proprietary single board computer that is shipped preprogrammed and fully capable of interpreting wireless instructions and turning multiple devices on and off. To our knowledge, the PT1000 is the only single board device that is capable of doing so. Nighthawk has taken separate functions historically carried out by a combination of multiple circuit boards requiring customized programming and packaged it together on a single circuit board that is preprogrammed and ready for use by the customer on its arrival.

The PT1000 is connected to existing power at the customer location. This power can be traditional electric power or solar or battery power. The PT1000 utilizes this power to drive a microprocessor which interprets instructions sent wirelessly by the customer. Based on these instructions, the PT1000 can drive up to eight independent relays, allowing the customer to turn on or off eight items.

All other Nighthawk products described below are variations of the PT1000. Based on customer feedback and experience gained in selling the PT1000, Nighthawk has taken the PT1000 and modified its physical characteristics and capabilities to fit into custom enclosures that are best suited for specific, widespread applications within certain markets and industries. The broad capabilities of the PT1000 are often not needed by customers, who may want to disconnect a single device for a preset time period, and therefore have no need for the ability to manipulate up to eight relays for variable time periods. Custom enclosures enable customers to receive a true plug and play Nighthawk product that is ready to use out of the box for their particular application.

### **FIRMWARE**

A key feature of the PT1000 is its operating firmware, written and owned by Nighthawk, which resides in an on-board microprocessor and is utilized to operate the PT1000. This firmware allows all necessary functions to take place on a single circuit board, reducing the size of the overall product and eliminating any programming or engineering by the customer. This on-board firmware provides the customer with an intelligent product that is capable of receiving a

single wireless message consisting of only a few characters and carrying out multiple tasks. For instance, installed in a fire station, a single message sent by the 911 operator to a PT1000 could simultaneously: 1) turn on lights in the firehouse for 20 minutes; 2) sound an audible alarm for 1 minute; 3) permanently turn off an electric stove; 4) change a traffic signal to red outside of the firehouse for two minutes; 5) open a voice channel for communications with the 911 operator; 6) open the bay doors and subsequently shut them; 7) lock the doors to the firehouse; and 8) enable a security system after five minutes. Because Nighthawk products can utilize alphanumeric messages for activation, a message could also be sent to a printer giving details of the emergency, which is known as the "rip and run" feature.

Nighthawk's firmware also allows customers to group their assets in up to 99 different groups, meaning that a single message can be used to activate multiple devices in custom groups. This feature provides for the most efficient and effective way for multiple devices at the same time, and makes Nighthawk products, particularly the emergency alerting products, the most effective mass notification tools in the market today.

Nighthawk's PT1000 firmware is modified to operate all of its application-specific, plug and play products described below.

## **WIRELESS ACCESS**

The Nighthawk single board computer, found in all of its products, is designed to interface with various wireless networks, whether public or private. Nighthawk currently supports applications on traditional paging networks, CDMA cellular networks, and ReFLEX narrowband PCS networks. Nighthawk is developing new wireless interfaces that will allow Nighthawk products to be deployed on spread-spectrum networks such as commercial grade WiFi/WiMAX networks and mesh networks that support new protocols such as Zigbee. These interfaces will open up a greater marketplace for Nighthawk to penetrate. It is Nighthawk's desire to produce a product that is agnostic to wireless protocols to support as many applications as possible, regardless of the type of network utilized or maintained by the customer.

However, Nighthawk should not be defined by the wireless method used to touch its products remotely but by the applications performed by remotely switching power. The simplicity of being able to remotely cycle power at a moment's notice presents Nighthawk with many high density device opportunities. Most customers care about the ability to turn something on or off at a moment's notice—they care much less about how it is done, as long as it is affordable. Some companies desire telemetry solutions, but are paralyzed by the fear of choosing a wireless technology that may become outdated with the next advance in wireless technology.

Nighthawk is nimble enough to create custom wireless interfaces that can meet the specific application needs of its customers. This positions Nighthawk not only as a manufacturer but a solutions partner, leading to the opportunity to sell multiple products to the same customer over long periods of time.

During 2007, Nighthawk developed its *Utility WebConnect™* software platform. Nighthawk electric utility customers that purchase this service are able to access the program, which is hosted on a Nighthawk-owned server, to use to manage and activate their Nighthawk units. The software program contains a database of all of the customer's units, and allows the customers to point and click to access the units instead of dialing a phone number and manually entering in instructions. Passwords, codes and relevant instructions are encoded into the platform, making Nighthawk's CEO700 much easier to manage and use. The database is interfaced to the proper wireless network, so the customer never sees or communicates directly to the underlying wireless services carrier that is utilized for their units. During 2008, Nighthawk plans to extend this service, under a different name, to non-utility customers using other Nighthawk power control products.

## MARKETS AND PRODUCTS

We believe the success that Nighthawk has enjoyed over the past two years in gaining traction in its core markets has the Company well positioned to take advantage of surging demand for Machine to Machine ( M2M ) related products. There are more than 50 billion machines inhabiting the planet today (Source: Wolfgang Grulke, Chairman of Future World), and technology experts such as Forrester Research have predicted that There will be more invisibly connected machines and physical objects than visible humans from 2005 onward. Historically, M2M communication technology has been referred to by many names, such as telemetry, pervasive internet, remote monitoring and telemanagement. Simply put, M2M technologies enable communication, wired and wireless, between two electric devices. The outlook for the M2M marketplace varies by source, but overall the outlook is extremely positive over the next five years. Some examples include the following:

By 2007, there will be between 100 million and 160 million machine-to-machine connections worldwide that use wireless mobile phone networks. (Source: Gartner Group)

Machine-to-machine communications could grow by 49% per year until 2010, with revenues surpassing \$270 billion and more than 100 billion objects communicating wirelessly. (Source: IDATE)

The M2M market is expected to grow to \$270 billion by 2010 as industries look to harness today's massive computing power and apply it to everyday electronic devices. (Source: Ray Jones, head of IBM's Sensors and Actuators division)

While the number of potential uses of Nighthawk products across many markets is virtually unlimited, Nighthawk has historically focused on three primary markets: electric utilities, wireless service providers and



transportation/emergency notification. Each has differing needs, but the applications in these markets are all characterized not only by the need to save the time and/or money associated with a problem that they know will occur, but also the inability to predict exactly when that problem will occur. Within each of these markets, Nighthawk has identified recurring, common problems that its technology can eliminate or resolve. In an effort to provide the least expensive, easiest to use products for these applications, Nighthawk has simplified the capabilities of its PT1000 control board described above, and created a plug and play product in a standard enclosure that is ready to use upon delivery to the customer. The units arrive fully programmed specifically for the application that they are being purchased for.

The most basic M2M application today is the need to be able to control power to devices in order to turn them on, off, or cycle power to them. This basic functionality is at the core of every Nighthawk device and application.

## **ELECTRIC UTILITIES**

As energy prices continue to soar, utility providers are increasingly searching for technologies and products that will facilitate the optimal distribution of power and effectively lower costs associated with doing business. Slowly but surely, state and federal agencies are pushing the burden of energy conservation and near real-time re-connection of previously delinquent energy accounts onto the utility provider and their customers as well. Within the utility industry, Nighthawk's whole house disconnect product (CEO700) and load-control units (PT1LC) have been extremely well-received in recent years and are gaining increased traction.

### **CEO700**

Ideal for troubled accounts, seasonal use buildings, student apartment complexes, and remote safety disconnect, the CEO700 is a completely integrated wireless remote power connect/disconnect package that does not interfere with automated meter reading ( AMR ) programs.

The CEO700 provides a significant Return on Investment ( ROI ) case for utility customers due to its ability to greatly reduce costs and security concerns associated with manually deploying field technicians in order to disconnect and reconnect service to a particular customer.

In many cases, a utility provider will make up to three visits to a delinquent paying customer. The utility provider will typically send field personnel once, to warn the customer of upcoming disconnection, a second time to disconnect power, and a third to reconnect power once payment is made. Hard costs associated with this process range from \$20 to \$250 per visit depending on a number of factors such as customer location and number of utility personnel deployed to execute a particular task. In many cases, more than one service technician must be deployed at one time due to concerns for the employee's well-being. Nighthawk products are ideal for this application due to their ability to allow for the remote connect/disconnect of energy for delinquent accounts as well as for seasonal residences which may require multiple visits each year and customers in remote rural locations.

ROI for this application is quite easy to calculate by simply multiplying the total number of off-cycle trips taken each year to execute related tasks by the average cost of each visit.

A 2004 survey of 118 utilities conducted by utility industry research firm Chartwell Inc. found that only 3% of electric utilities had adopted a remote disconnect technology, but more than 50% of electric utilities planned-to-use, or were considering using technologies that would allow for the remote connect/disconnect of energy meters. Additional findings from the report estimate that approximately 2.3% of the United States' electric meters were individually disconnected and reconnected on more than four occasions resulting in estimated costs of nearly \$1.2 billion dollars for utility providers. Nighthawk was one of the few companies providing remote wireless disconnect solutions back in 2004. Due to its expertise and experience in deploying wireless remote control solutions, and the number of electric utilities that have already successfully implemented remote disconnect programs using the CEO700, Nighthawk is extremely well-positioned to capitalize on growth opportunities within the utilities industry.

## **PT1LC**

Load control programs are commonly put in place at electric utilities to avoid power shortages within their grids during peak demand periods and the need to purchase expensive energy on the spot market. Designed for utility load control programs, the PT1LC remote control switch uses wireless signals from commercial and private networks for wide area control of residential and commercial loads. Northern utilities typically install load control devices on electric hot water heaters, while Southern utilities typically place them on air conditioners.

Nighthawk solutions enable utility providers to save energy, shift power, and manage power more efficiently by remotely controlling the on and off functions of thousands of electric devices. For example, a utility provider can utilize the group call function of Nighthawk's one-way communication system to transmit a digital message that would disconnect 10,000 air conditioning units for 10 minutes in order to save energy, reconnect energy to the initial 10,000 units, and then disconnect power to another 10,000 air conditioning units in another area of the organization's power grid. The Nighthawk solution is also capable of activating or deactivating all or some of the units in a particular power grid and is able to dictate how long particular units will be shutdown manually or remotely, all with a click of a mouse.

Nighthawk currently serves more than 50 electric utility customers in 23 states, and continues to view the utility market as the largest near-term source of revenues. As Utilities continue to expand automation and decrease manpower, Automatic Meter Reading (AMR) and Remote Disconnect are becoming important parts of a utility company's strategy. While AMR systems have been offered for over 20 years, it is only in the last 3 to 4 years that they have become commonplace. The same is being seen now for remote disconnect.

The North American Electrical Utilities currently consists of 3,300 utilities serving approximately 120 million end customers. Of the 3,300 Utilities only the top 500 serve more than 20,000 customers with the remaining 2,800 representing small population centers, typically in rural areas. Nighthawk currently focuses on solutions for the high cost accounts that require excessive utility resources to manage. While the need to manage these accounts has always been an issue, two key factors have significantly raised its visibility. Those factors are deregulation, which will make it increasingly difficult for utilities to absorb these costs, and the availability of a viable cost effective solution.

Deregulation has forced new awareness of costs that may have been previously ignored. In a regulated market it was much easier of a utility to summarize all of their costs, including those associated with problem accounts, and present this to the local board of public utilities to justify a service rate that would still return them a profit. In essence, these bad accounts were subsidized by the good accounts in the utilities service area. Deregulation and subsequent competition have forced a change in the way this is managed.

Automatic Meter Reading (AMR) has also brought with it a renewed interest in the metering aspect of the business. Utilities are looking for ways to gather better information about customer demand other than the monthly consumption total. AMR will allow the users to gather information from meters at any point in time, to offer variable billing schemes to promote usage in non-peak hours and for immediate outage notification.

The pace of technology deployment continues to escalate as utilities are now looking even beyond AMR to Advanced Meter Intelligence (AMI). AMI will offer tools to the utility to not only read the meter but to offer Time of Use rates that will vary during the day as demand nears the capacity a utility has to deliver power and more importantly the ability to control loads. AMI will incorporate

two-way communications with sizable bandwidth, meters with a disconnect switch incorporated under the glass, and Zigbee local RF communication. While this will likely impact our opportunities for disconnect at large investor-owned utilities, it will open up a much larger opportunity for both utility and customer-controlled load management products. The electric utility will most likely evolve into a communications portal, capable of communicating with other energy consuming devices on the customer's premise and reporting usage and billing information to the utility on a more frequent basis.

The opportunities for Nighthawk in the Utility market will vary. We believe we will continue to see the increasing demand for the CEO wholehouse disconnect products as part of or in some cases as the primary strategy for cost reduction. We will also, however, see a dramatically expanded market potential for load shed devices as AMI takes hold. Nighthawk holds a potentially valuable position in this arena because of the abilities of the PT1000, which can be utilized to control multiple appliances from a single device, and with a single message. Nighthawk is the only company, to our knowledge, whose primary business has been turning on and off multiple devices that may lie beyond the meter on the customer's premise.

## **WIRELESS SERVICE PROVIDERS**

The proliferation of wireless, IP-based communication networks (WiFi and WiMax) has created a growing need for the ability to control remotely located digital equipment, primarily routers. The devices are plagued by software and hardware lockups due to poor power availability, static, viruses, etc. Routers, as well as other digital equipment such as cameras or servers, are often placed at retail sites such as strip malls where the power glitches are frequent, or outside on poles where they are subject to weather changes and static electricity that can affect their performance. The very nature of IP-based equipment makes it susceptible to trash from the Internet which may hinder its performance. Industry experts have stated that over 80% of computer-related issues can be solved through a simple equipment reboot.

Nighthawk solutions are valued in this market because they provide an out-of-band control solution. While numerous IP-based control solutions exist, the ability to reach those control solutions is sometimes negated by the fact that the IP network itself is unavailable. The value of such an out-of-band solution was evidenced by the order of over 3,000 Nighthawk rebooting devices by Mercury Online Solutions (now owned and operated by 3M) in order to control power to thousands of digital display kiosks for AT&T Wireless. The Nighthawk solutions are also valued in this market because on-call technicians can access the units from almost anywhere via a telephone (landline or cellular), and do not have to have Internet access in order to command the unit to reboot.

The products that have been developed and deployed for this market segment include:

**NH100**

The NH100 allows a user to remotely control power to any device that can be plugged into a standard household outlet. It can be accessed from a telephone, and come programmed with a power cycling function that allows the user to call it once, and have the unit power down and subsequently power up a device. As such, the unit is often used to reboot routers. The preset timing for the power cycle is one minute, but the interval can be increased or decreased through commands sent over the telephone. The NH100's smaller size and its ability to incorporate an external antenna make it perfect for inclusion with telecom equipment in an enclosure on a pole or tower. To our knowledge, the NH100 is the only commercially available wireless rebooting unit available today.

## **NH8**

Designed with the ISP, Data Center, or computer user in mind, the NH8 also allows the user to reboot locked up equipment remotely. However, with 8 individual time-delay programmable 15-amp outlets, customers using the NH8 are capable of full power-off reboots of eight different devices. The NH8 comes standard in a 19" rack mount, 2U form factor.

## **TRANSPORTATION/EMERGENCY NOTIFICATION**

Because Nighthawk products allow the easy and immediate activation of single or multiple devices, they are often used to activate sirens and alarms. Their ability to receive and display or print messages also has them well positioned for use in a wide variety of traffic control and emergency notification applications. The extremely low power drain of the Company's PT1000 makes it a perfect solution for remote signage and alarm applications, where the amount of power available is limited, often coming from solar panels or batteries.

Nighthawk solutions enable the remote activation of intermittent warning signs such as **ICY ROAD** and **LOW VISIBILITY AHEAD** and also allow the customer to remotely manage weigh station accessibility and activate processes such as bridge de-icing systems. The PT1000 is commonly used as an affordable method of activating flashing beacon signs used in conjunction with weather warnings, construction and highway advisory radio systems. The Company plans to grow this segment of its business over the next few years as demand for product continues to grow.

Because the Company's products enable on-demand activation of alarms and signs, as well as the ability to push a message through to a printer or digital display, the company views the civil defense industry as a key area for future growth and has solutions in the development and completed stages that will interface with existing emergency notification systems in order to optimally notify all necessary parties of a potential natural disaster/emergency.

The majority of first responders across the United States are fire/EMS departments. According to the National Directory of Fire Chiefs there are 28,921 fire departments with a total number of firefighters at 939,473. There are an additional 451,424 emergency personnel. The majority of these departments are small and 71% are strictly volunteer. Many of these fire stations need upgrades to the existing systems to address the ever-growing need for reliability, quick response and accuracy. These upgrades include:

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Firehouse Automation & Alerting

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Volunteer Alerting

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Public Emergency Notification

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EMS Automation & Alerting

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Weather/Threatening Incident Alerting

Emergency notification is most commonly associated with the efforts undertaken by all levels of government, such as state and federal departments of transportation, and first responders to improve communication networks after September 11, 2001. However, there are emergencies that occur daily that require timely and accurate dissemination of information and alerts like fire station alarms, weather sirens and amber alerts. Nighthawk products currently address the growing needs of public and private sectors to deploy communication solutions that will provide timely, accurate and responder-specific warnings, messages or instructions in times of crisis in order to save lives, maximize public safety and expedite emergency response.

Emergency notification is a rapidly developing marketplace where officials at all levels of government and industry are responding to the demand for improved emergency notification networks. They are concerned about the timeliness and accuracy of emergency messaging and are looking for solutions that are responsive to these needs. Although this market has grown much more slowly than the need suggests, state and local governmental agencies have now begun

to spend money for system upgrades and new systems.

We believe a reason Nighthawk has become a preferred solution is that our emergency notification products work seamlessly with most CAD systems, particularly with Motorola, due to the ability of CAD systems delivering TAP (Telecator Alpha Protocol) messaging for alpha/numeric paging. TAP is one of the earliest protocols for alpha/numeric paging to hit the commercial subscriber paging industry dating back to the early 1980's. TAP is accepted universally on an international basis. Some of the applications for which first responders integrate the Nighthawk products into their CAD systems include early warning systems for civil defense, tsunami sirens, lighting detection systems, and tornado sirens. In addition, we have other products deployed for this market segment to include:

### **FAS8**

The FAS8, which is a modified PT1000 placed in a custom enclosure for easy placement in a firehouse, is currently the flagship product for firehouse automation. It is capable of activating up to 8 electric devices within a firehouse or any other facility simultaneously or individually. If additional devices require management, the user simply deploys another Nighthawk unit. In firehouse environments, where hearing and understanding human verbal commands is extremely difficult with the presence of excessive noise, Nighthawk products are able to activate and de-activate a number of critical devices such as public address systems, wake-up alarms, bay door control systems, emergency lighting systems and electric stoves. The FAS8 enables the simultaneous transmission of a digital message to a serial printer within a firehouse directly from the 911 system operator. By transmitting valuable information related to the type of emergency at hand, location of the emergency, and driving directions to a serial printer, the Nighthawk solution essentially creates a rip and run environment where emergency personnel simply need to wake-up, get dressed, and collect a document from the printer while exiting the station for an emergency.

### **EA1**

Designed with rural and smaller urban volunteer fire districts in mind, the EA1 is the perfect solution for alerting fire fighters at the station or volunteers in their homes. The EA1 will activate a built-in audible alarm and any 15 amp electrical device such as a lamp that is plugged into the faceplate outlet. At the same time, it can print out instructions to the firefighter. Other options include a strobe light and digital message delivery to an LED sign or a printer. The Company has recently begun receiving inquiries into using the EA1 for in-factory emergency notification.

### **EAU**

The Emergency Alert Unit ( EAU ) serves multiple purposes within the broader emergency notification market. It serves primarily as a more effective method of alerting large groups of people in public locations or security offices of

public facilities. In this application, the EAU is generally desk or wall mounted and is installed in high-traffic locations or security offices. When paged from



dispatch, the device will emit an unmistakable audible alarm and activate a scrolling message on the LED sign. The EAU is the Company's newest product for emergency notification of the general public and customers indicate it will be used for a variety of emergency situations such as extreme weather, chemical spills, and terrorist threats.

## **NEW PRODUCT DEVELOPMENT/PRODUCT ENHANCEMENTS**

As a result of increased exposure of our products across all of our markets, Nighthawk often receives requests for products to solve new problems in various markets. To date, Nighthawk has been careful to consider only requests that utilize its core technology and that may lead to additional sales opportunities across a large market. For example, Nighthawk has developed the Hydro 1, a remote control product for commercial irrigation managers and water utilities. The development the Hydro 1 was paid for entirely by a grant from the State of New Mexico's Water Innovation Fund.

Nighthawk continues to take steps to ensure that it meets the needs of its target markets and customers. In order to be responsive to customer requests and to take advantage of commercial opportunities, the Company hired a Director of Engineering and Product Development in October 2006. This individual brings to Nighthawk more than 20 years of expertise in networks, protocols, embedded devices and advanced wireless technologies. He has integrated wireless devices with enterprise systems in the United States, Canada, Europe and South America. As revenues continue to grow and the customer base expands, Nighthawk will hire, or engage on a contract basis, additional engineering resources to provide ongoing product development, and pre- and post-sales support. During 2006 and 2007, the Company expensed approximately \$101,160 and \$53,950, respectively, on research and development efforts.

One area of current focus is the consumer market for remote power control and emergency notification products for both personal and residential uses that are just now beginning to emerge. Historically, most consumers have thought of remote control in a recreational sense, such as turning on or off a television or stereo. However, Nighthawk products take remote power control to new levels as they provide ways to save money and lower the risk of liability by replacing processes that require human intervention with processes that can be controlled remotely. Opportunities exist for companies that provide intelligent wireless solutions both with respect to remote power control, but also emergency notification into the home. Through strategic relationships, Nighthawk intends to enter this marketplace with consumer-centric products.

During 2007, the Company began implementing a plan to consolidate its capabilities used in the PT1000, NH100 and CEO700 onto a single circuit board. Historically, Nighthawk has used separate printed circuit boards for each of these products, its most commonly sold products. During 2008, the Company expects to begin utilizing a single printed circuit board design that is not only capable of meeting the needs of the applications that typically require Nighthawk products, but that will have enhanced capabilities as well. Utilizing one common board will allow Nighthawk to order a larger quantity of the boards from manufacturers at a lower per-board price, in spite of having increase functionality on the board. This board will also be capable of hosting several different wireless radios that utilize both one-way (Pocsag and Flex paging) and two-way (ReFlex, Cellular and Zigbee) protocols.

## **PATENTS PENDING**

During 2006 and 2007, the Company decided to abandon efforts to obtain two patents on power control products that had been underway for over 5 years. Rather than continuing to pursue and incur costs related to those efforts, management has decided to pursue the development of next-generation products that it feels will be more proprietary in nature and more easily patented.

## **COMPETITION**

Competition is found in each of the vertical markets where Nighthawk has a presence although in most instances, the competitor's devices operate on completely separate communications platforms. It is interesting to note that most of these competitors provide solutions for a single industry rather than applying their knowledge and technology to other applications. Competition is more defined in the utility industry as there are multiple companies offering similar or more technologically-advanced products.

Competition in the emergency notification industry continues to evolve as the Department of Homeland Security and its regional, state and local offices struggle to determine how to improve their capabilities and identify budgets to support needed upgrades. While this is being resolved, Nighthawk's Advisors are working to position the Company so that its products will be among those utilized by agencies at all levels of government rather than other competitors products.

From a rebooting perspective, the industry terminology for remote reboot applications is telemanagement applications. The telemanagement market place is a billion dollar industry. The industry standard for remote reboot applications is IP-based solutions. IP based rebooting solutions are very robust in terms of multilayer applications for monitoring and needs. IP-based solutions also provide two-way communication via IP/WAN/LAN connectivity. IP solutions can be deployed on many different network configurations such as LAN, WAN, WiFi, and other wireless networks. IP-based solutions can monitor power and network connectivity for routers, servers, and other equipment that may need a power cycle to reboot/reset/remotely control the equipment for simple power on/off applications. The biggest advantage of an IP-based solution is the ability to do a soft reboot for computer servers that may need to shut down mission critical applications before a hard power cycle where the server is turned off before being powered back up. Another major advantage

with an IP-based solution is the ability for two-way communication for data acquisition. Two-way will allow the products to be automated through network application software (off-the-shelf or customized) so functions/data acquisition can be performed by criteria programmed into the application-based software to meet the IP requirements/needs.

There also are several disadvantages to an IP-based solution that have many IT departments looking for new out-of-band solutions. The main problem with an IP-based solution is that the solution rides their existing network infrastructure. This presents some challenges when the device is behind a router that is down. In this example, the IT department will need to perform a manual reboot which could mean that a field technician will need to simply walk across a room or campus to perform a manual reboot or it could mean that an IT department will need to roll a truck to fix the problem. Based on input from customers, this cost is estimated anywhere from \$50 to \$500 to perform the simple function of powering down/powering up a router or server. The other challenge for IT departments is that they have to be on-line to touch the IP devices. Technicians do not always have access to the internet to access their devices when they are in need of a power cycle.

Nighthawk devices can remedy both of these situations because they ride on a wireless network providing an out-of-band solution with access 24/7 whether or not the device sits behind a router that may be down. Technicians can also access Nighthawk devices via traditional land line telephone services and cellular phones services. The benefits to the IT professional that an out-of-band solution provides include lowering costs to maintain products in the field due to lower labor and vehicle costs because the service call is handled remotely. In addition, it provides quicker response time to bring a network back up resulting in less down time to LAN/WAN/WiFi networks. For Wireless Internet Service Providers (WISPs) this is an invaluable solution because it means less down time for their subscribers.

Here is the landscape of what Nighthawk faces in the realm of competition:

### **Utility Competition**

Comverge and Cannon Technologies advertise that they provide complete, end-to-end solutions for utility load management. Their services are expensive and must be engineered into the utility's network. Both of these organizations have worked hard to position themselves as part of major AMI or load management schemes.

Comverge operates several systems where they have deployed equipment at their own cost and collect revenue by offering Peak Shaving during times of high demand. In addition, Comverge has positioned themselves with several major OEMs such as Cellnet to offer a load shed option along with standard AMR to meet the newly formed demands of AMI.

BLP is a provider of paging-based control boards and represents the closest direct competitor to Nighthawk. BLP offers both Flex and POCSAG paging technologies combined with a network software solution. Excluding Centerpoint, BLP has in excess of 5,000 units operating in the field. Currently however, BLP's efforts have been

redirected and their focus is not on the utility market.

Carina Technology offers several solutions for two-way remote disconnect focusing on CDMA technology. The two-way feature of their products have gained them good attention from major IOU's however it also comes with a relatively high cost. They also promote outage management and Pre payment features although we are not aware of any utilities deploying these products to date.

Telemetric is a small, yet active competitor within the Electric Utilities market, but their product is more expensive due to the fact that it utilizes cellular technology, and it also does not offer the coverage that paging does.

### **Emergency Notification Competition**

Motorola has historically been active in all phases of technology related to public safety. They are a major producer of two-way radios, computer-aided dispatch systems (CAD), and historic two-tone alerting systems. Motorola has developed a variety of cutting edge products for dispatch centers, CAD systems, radio based alerting and fire equipment communications. For Nighthawk's purposes, Motorola can be described as the best type of competition. Their products are very expensive and generally do more than what most fire departments need or can afford. Their focus on two-way radios and CAD systems is actually complementary to the Nighthawk suite of products.

The Emergency Broadcast System, which utilizes sirens to direct people to turn into specific radio and TV stations for information are effective for those that hear them. The great limitation for cities that have siren systems is that the activation of them means only one thing to the population and that generally is tornado warning. The siren simply cannot communicate any other message. In limited cases, communities surrounding nuclear plants would understand that the siren carries a very different message. New siren systems are being deployed that have very loud voice commands detailing the nature of the emergency. This is effective as long as you can hear the message clearly. Siren systems are not an effective or efficient method of alerting rural citizens or those in less densely populated areas. Today few siren systems exist that are outside tornado or tsunami prone areas.

Reverse 911 systems are effective as long as a person answers the phone and understands the message. The major limits to this method are that only people near relevant phones get the message. Also a complete community wide notification takes significant time. Other message based notification systems only alert those that are on a specific list.

### **Firehouse Automation**

WestNet Systems, a California-based company has recently entered the firehouse notification market with a central microprocessor-based alerting center accompanied by a suite of peripheral firehouse products. These include lights, wake up alarms, digital displays and wiring kits. WestNet has concentrated primarily on what happens within the house and is not focused on the communications medium. They have a very impressive appearance and have invested heavily in marketing. Sales appear to be doing very well and the company appears to be benefiting significantly from strong marketing initiatives. However, the product is expensive and by our estimation Nighthawk will compete well and be able to gather a significant market share.

### **Telemanagement/Remote Reboot Competition**

DataProbe manufactures a product called iBoot. The iBoot solution includes several models for Single Point (iBoot) and Multi-point (iBootBar) applications. The iBoot solution supports both AC/DC power requirements. However, customers have switched to Nighthawk to gain an out-of-band solution. In addition, they were unhappy with the iBoot because often times it reboots itself with no commands from a technician.

Western Telematic is another major competitor in this field. They are one of the largest manufactures in the industry for rebooting solutions. Western Telematic manufactures single and multipoint solutions that support AC/DC power requirements.

Nighthawk is confident that current devices it has or will develop will provide the much sought after out-of-band solution.

### **SALES AND DISTRIBUTION**

During 2007, Nighthawk decided to focus the majority of its sales and marketing efforts in the electric utility industry, primarily on sales of its CEO700 product. This is because sales of the Company's CEO700's are typically higher-volume sales as opposed to sales of other Nighthawk products, and management determined that sales and marketing dollars spent in this area were more likely to produce better returns for each dollar spent.

Following is an outline of the current and future sales and marketing strategies:

### **Sales Strategy -- External**

In efforts to contain personnel costs, Nighthawk has an extended outside salesforce through resellers and agents that have been engaged to represent all Nighthawk products. These categories of representatives are defined as such:

**Electric Utility Resellers and Distributors** Nighthawk's Vice President, Utility Division, hired in October 2006, spent significant time throughout 2007 establishing a network of regional resellers and distributors that have had longstanding relationships with electric utility companies. These resellers and distributors are typically paid a commission on each sale brought to Nighthawk, although some are provided product at a wholesale price and are allowed to mark up the selling price to the end customer. The effort in 2007 was to bring in larger unit sales utilizing this network.

**Paging Resellers** Companies such as paging carriers that are willing to identify opportunities within their customer base and potential new customers. With minimal support from Nighthawk, these companies are capable of closing the sale of our products. Once the order is received, the reseller orders the products from Nighthawk and bills the customer directly. In addition, if customer service is needed, the customer will contact the reseller initially. Currently, Nighthawk is actively engaged with American Messaging, one of the largest paging carriers in the United States. Nighthawk also has agreements with over 10 regional and local paging companies.

**Agents** Companies such as electrical equipment distributors that are willing to identify opportunities within their customer base. Most often times, a Nighthawk sales representative becomes very involved in the sales process for the initial and subsequent orders. These customers are billed directly by Nighthawk and will call directly to Nighthawk for customer service support. Currently Nighthawk has formal agreements with 5 of the largest electrical wholesale distributors in the United States.

### **Sales Strategy -- Internal**

Inside sales representatives are responsible for:

.

Cold call follow-up (lists and timing based on marketing activities)

.

Mining the existing Nighthawk database

.  
Web inquiries

.  
Referrals

.  
Call-ins

.  
Making Webinar presentations

Currently, the inside sales representatives are responsible for understanding and presenting the Nighthawk products in all three vertical markets on which Nighthawk focuses: utilities, emergency notification/public safety, and IT/telecommunications. Pricing tiers have been tested to determine the most viable threshold to garner higher quantity sales while producing healthy profit margins.

Dependent upon the size of the opportunity, the sales person either closes the sale over the phone or engages a senior Nighthawk representative to continue the conversation. If the potential customer is interested in a pilot program, the inside sales representative has the ability to secure a minimal order for the program within any industry to which Nighthawk markets its products. It has been found that to substantially increase the orders from a specific customer following a successful pilot program, a face-to-face meeting is required. This meeting is currently conducted by Nighthawk senior executives and/or the direct sales representative in the utility market which has proven to be very successful.

Understanding that Nighthawk has customers that will only order a limited number of devices, usually for rebooting, because they only have a need for a few devices, these efforts will continue to be a focus for the inside sales representatives. Although these opportunities are limited, they are provided the same customer service and follow up communication so as to gain referrals, if possible.

In addition to the inside sales effort, Nighthawk utilizes the expertise of its Vice President, Utility Products Division to focus on the growth of the utility business. He is very knowledgeable in the utility industry bringing with him strong contacts, relationships, and information concerning opportunities in the marketplace. He will be responsible for designing and managing a reseller network with the United States for the Company's utility products.

As sales continue to grow, additional sales representatives, both inside and industry-specific direct, will be added to the Nighthawk staff. In addition, a sales coordinator will become paramount in Nighthawk's sales efforts by managing



the sales order process, production updates and customer follow-up, so that the salespeople can focus on generating revenue.

## **CUSTOMER CARE**

At the heart of the Nighthawk sales strategy, both currently and in the future, is customer care. This is a very high priority and includes a follow-up process on closed orders for which the sales representative:

- .
- confirms ship dates with production;
- .
- informs the customer of ship date via e-mail and/or telephone;
- .
- contacts the customer to confirm receipt of the product and answer any questions within 3 days of the expected delivery date;
- .
- contacts the customer to see if they have installed the product and poll their satisfaction two weeks following delivery of the product;
- .
- contacts the customer to see how the products are working and determine incremental needs within sixty days following delivery of the product; and
- .
- continue to touch base with the customer at least every 90 days to continue building a relationship with them.

## **CURRENT MARKETING STRATEGY**

Nighthawk utilizes a customer relationship management ( CRM ) tool to gather and cultivate better information for the company to ultimately enhance sales efforts and achieve sales goals. By collecting data on potential customers in as much detail as possible, the process of marketing to these prospects becomes more efficient and cost-effective. In addition, tracking potential sales opportunities becomes more succinct allowing for senior management to determine

the most effective team sales effort to meet and exceed the company goals. Salesforce.com, an internet-based CRM tool, is currently utilized to allow Nighthawk personnel in the San Antonio, Dallas, Denver and New Jersey offices the ability to share information in one centralized database.

The current marketing programs being executed with a strategic follow-up plan is measured for success utilizing the CRM tool. Marketing activities include:

#### **TRADE SHOWS**

.

Display at industry-specific trade shows for the utility and public safety sectors at least 6 national and 6 regional shows

Provide on-going support for Resellers/Agents at trade shows providing customized materials and attendance by Nighthawk representatives to promote our products

Follow-up on leads gathered at trade shows is conducted through written communications sent via mail or e-mail. All mailings/e-mailings are timed to allow our inside sales representatives the opportunity to follow up with a phone call in a reasonable amount of time.

## **MARKETING COMMUNICATIONS**

New marketing communication vehicles have been developed to re-brand and strengthen the Nighthawk image thus building a stronger, more recognizable brand. Critical elements of this function are:

**Website --** The appearance, quality and operability of the web site is of paramount importance. Currently in progress is development of a search engine optimization plan that will be implemented beginning in the second quarter of 2008. This critical element is key to the growth of the rebooting market for which most of Nighthawk customers seek out its solution over the internet as they are IT decision makers. Visitors of the Nighthawk website, [www.nighthawksystems.com](http://www.nighthawksystems.com), can request additional information concerning featured products. All web inquiries feed directly into the Nighthawk CRM tool allowing for immediate follow-up for which we have about an 80% close rate for these leads.

**Print Advertising** Half-page ads that are relevant to the targeted audience are placed in industry-specific publications based on editorial content. Additional distribution of the publications in which Nighthawk advertises occurs at trade shows at which we exhibit. The purpose for advertising is to drive traffic to the newly-designed website and continue to strengthen brand presence in key industries. In addition, the print publications gather leads from its readers that are provided to Nighthawk for follow-up.

**Direct Mail/E-mail** Event-specific and industry-specific direct mail campaigns are utilized to introduce Nighthawk products, follow up on leads, re-engage old customers, and build brand awareness. Pertinent lists are identified and pulled based on availability on the Internet or through purchase of existing organization lists. The inside sales representatives then follow up in a reasonable time frame to discuss the mailing and inquire about product interest.

**Internet Product Features** Product placement on industry-specific websites will be utilized to gather new leads. In addition to the search engine optimization efforts, the hosts of these websites execute their own campaigns for which Nighthawk will benefit. The placements feature product photos, deployment examples and product information.

Webinars - for both training sales representatives and assisting in selling Nighthawk products. A large number of customers or sales agents can be reached through Webinars making our flow of information more efficient while cutting travel expenses.

## **ASSOCIATION MEMBERSHIP**

Nighthawk executives participate on key association committees such as the Emergency Communications Committee for the American Association of Paging Carriers (AAPC) which provides continuous exposure to key players in targeted industries. Membership in these associations provides Nighthawk with access to the other members to promote its products and identify potential resellers.

Expansion of our marketing efforts to more clearly reinforce Nighthawk as an industry expert in wireless remote control devices are currently being developed to include:

.

Quarterly Newsletter

.

Customer Survey for the development of case studies and opportunity to ask for referrals

.

Speaking Engagements within speakers bureaus and at conferences/trade shows for Nighthawk senior management

.

Round table discussions hosted by Nighthawk for senior-level executives (as a stand-alone event or in conjunction with a larger event as a sponsorship)

## **SET-TOP BOX ( STB ) PRODUCTS**

## **MARKETS AND PRODUCTS**

Nighthawk designs, manufactures and markets the MediaPro IP5000HD and the MediaPro IP3000HD set-top boxes.

The STB s deliver full video and computing functionality in a compact footprint in a very quiet, fanless package that enables a wide range of on demand, IP-based applications including high speed Internet access, streaming IP video, digital audio/music, video on demand, 3D gaming, video conferencing and more. Either standalone or in conjunction with various third-party middleware software, the STB products deliver a full range of high quality, standard and high definition entertainment and information services that can generate revenues to hotel and casino owners, as well as to telecom service providers, hospitals, apartment/condominium owners, schools and

other similar entities. The STB's also enable telecommunication service providers to deliver IP-based broadband and television services to their customers. Currently, the Company's primary market is the hospitality industry, which is in the midst of upgrading in-room video and television services technology.

The IP5000HD was the Company's original high definition STB and is an MPEG-2 high definition hospitality box with a hard drive and IPTV PVR (Personal Video Recorder) capabilities. To the Company's knowledge, it was the first high definition IP set top box on the market to ship and be deployed in volume when it was installed at a major Las Vegas hotel in mid-2005. The IP5000HD was designed to be a high-end, premium unit that would command a premium price, because it includes a complete Intel-based PC (running either Windows XP or Linux), as well as set-top box functionality capable of delivering a full range of video, Internet and other interactive services which hotels are increasingly demanding to satisfy the needs of their guests. The IP5000 includes Intel-based PC infrastructure, so it is a more expensive unit to manufacture than the newer System-On-a-Chip STB's, such as the IP3000HD model described below, which combine both graphics processing and computing processing into a single chip architecture. While the IP5000HD is currently being sold in hospitality markets, it's also in the early stages of exploiting a secondary market opportunity as an IPTV PVR STB. This secondary market for the IP5000HD is expected to continue until its PVR capability is superseded by a modified version of the IP3000 in which we expect to add a hard drive to go after the IPTV PVR market more cost effectively.

The IP3000HD, Nighthawk's newest STB, is a leading-edge MPEG-2 / MPEG-4 high definition box which debuted at the June 2007 HiTec Hospitality Technology Show. It offers an Opera browser and Java Script capabilities allowing servers to dynamically download applications to run remotely on the box.

Since its acquisition of the STB business on October 11, 2007, Nighthawk has been selling the IP3000HD to one of the largest providers of hospitality broadband services whose installations total over 500,000 rooms in over 3,000 hotels worldwide under the terms of an agreement that provides per unit pricing for in excess of 25,000 units.

A number of major network integrators that supply in-room entertainment systems to the hospitality industry are potential Nighthawk STB customers. The IP3000HD and the IP5000HD give Nighthawk enough flexibility to cover the wide variety of needs of the lower to upper tier hotel and casino properties throughout the world in an economic fashion.

## **NEW PRODUCT DEVELOPMENT/PRODUCT ENHANCEMENTS**

Based on discussions with the various integrators of IP and television services to the hospitality industry, Nighthawk is constantly reviewing requests for the addition of new features and capabilities to its existing line of STB's. In late 2007, Nighthawk began working with Verimatrix, Inc. to become one of the first set-top box providers in the hospitality industry to offer digital watermarking, and process through with video streams would be encoded with a watermark that would be visible if the content were recorded and removed from the hotel premise in an unauthorized fashion. Such watermarking would allow for stolen video to be traced to its point of origin, and would serve as a

deterrent for unauthorized use of video content provided in hotels and casinos. In 2008, Nighthawk will begin offering its own Software Developers Kit to potential customers in an effort to create sales opportunities for the STB's. From its acquisition of the STB business on October 11, 2007 through December 31, 2007, Nighthawk expensed \$33,573 in research and development costs related to the STB business.

## **PATENTS**

Nighthawk received two patents with the acquisition of the STB business. The first is for an improved patch antenna for a set-top box. Using a patch antenna as the set-top box's antenna advantageously solves the problem of interference that could result from the metal enclosure if other types of antennas were used. Using a patch antenna and locating the patch antenna behind the bezel hides the antenna from the user's reach, and thereby advantageously avoids the user from having to carefully place or adjust the antenna.

The second patent is an electronic system that includes control logic that causes input and output ports to be disabled during the interruption windows of the initialization process, and subsequently to be selectively disabled or enabled after completion of the initialization process. This is done to prevent interruption of the initialization process by the user. The input and output ports are disabled or enabled, after completion of the initialization process, to control access to content sorted on, or made available by, the electronic system. This process prevents the Company's software from being used on non-Nighthawk set-top boxes.

## **COMPETITION**

Amino Technologies, based in England, designs and supplies set-top boxes for a wide variety of applications, including for use within the hospitality industry. Amino has a larger current market share than Nighthawk, primarily based upon the use of its standard definition set-top boxes.

Advanced Digital Broadcast (ADB) is headquartered in Geneva, Switzerland. ADB on its website claims to have more than 700 employees and to have sold more than 10 million digital set-top boxes worldwide since 1995.

Motorola manufactures set-top boxes that are used by telecom service providers such as AT&T for use in retail consumer service offerings, but to date does not have a large presence within the hospitality industry with high definition set-top boxes.

## **SALES AND DISTRIBUTION**

Nighthawk currently utilizes the services of an outside consultant as well as one in-house sales person to sell its STB's. Products are built and shipped directly to customers from one of several manufacturing sites in Asia.

## **CURRENT MARKETING STRATEGY**

Nighthawk's current strategy is to build on its recent success with both the IP3000HD and the IP5000HD boxes to attract new hotel services integrators as customers. The two engineers hired as part of the acquisition of the STB business each have excellent reputations with several integrators within the industry. As discussed above, to the Company's knowledge, it was the first Company to ship and deploy a high definition IP set top box in volume when it was installed at a major Las Vegas hotel in mid-2005. It has also gained traction in the market with the current customer that is purchasing the IP3000HD. Nighthawk's staff has developed a positive reputation for providing proactive customer support in the installation and integration of its STB's, and is currently in negotiation with several potential customers that would like for the Company to design a set-top box to fit their particular needs.

## **ITEM 1A. RISK FACTORS**

**OUR INDEPENDENT AUDITORS HAVE ISSUED A GOING CONCERN OPINION AND IF WE CANNOT OBTAIN ADDITIONAL FINANCING, WE MAY HAVE TO CURTAIL OPERATIONS.**

Our auditors, GHP Horwath, P.C., included an explanatory paragraph in their Report of Independent Registered Public Accounting Firm on our December 31, 2007 consolidated financial statements indicating that conditions exist that raise substantial doubt about our ability to continue as a going concern. We will require additional funds in the future, and any independent auditors report on our future financial statements may include a similar explanatory paragraph if we are unable to raise sufficient funds or generate sufficient cash from operations to cover the cost of our operations. The existence of the explanatory paragraph may adversely affect our relationship with prospective customers, suppliers and potential investors, and therefore could have a material adverse effect on our business, financial condition and results of operations.



OUR CONTINUED EXISTENCE IS DEPENDENT UPON OUR ABILITY TO RAISE ADDITIONAL CAPITAL, WHICH MAY NOT BE READILY AVAILABLE.

From inception, we have generated funds to cover operating cash flow deficits primarily through the sale of equity securities or the issuance of debt that is convertible into securities. We may not be able to continue to sell additional securities. We expect to raise funds in the future through sales of our debt or equity securities until a time, if ever, that we are able to operate profitably. We may not be able to obtain funds in this manner or on terms that are beneficial to us. If we are unable to obtain needed funding, it can be expected to have a material adverse effect on our operations and our ability to achieve profitability.

WE DEPEND ON CERTAIN CUSTOMERS AND IF WE LOSE ONE OF OUR SIGNIFICANT CUSTOMERS, OUR REVENUES MAY SUBSTANTIALLY DECREASE AND OUR BUSINESS MAY FAIL.

During the year ended December 31, 2007, one customer that purchases STB's from us accounted for 30% of our total revenues for the year. Additionally, a second customer that resells our products to electric utilities accounted for 13% of our revenues in 2007. If either of these two customers stop generating orders for us altogether, and we are unable to obtain comparable orders from other customers, our revenues would decrease and it could have a material adverse effect on our business.

WE DEPEND ON KEY PERSONNEL AND OUR BUSINESS COULD BE ADVERSELY AFFECTED IF THEY WERE TO DEPART.

Our success depends to a significant degree upon the continued contributions of our key management and technical personnel. Our business requires highly skilled hardware and software engineering personnel. H. Douglas Saathoff currently serves as both our Chief Executive Officer and the Chief Financial Officer, and has experience in raising capital for small cap companies and providing financial oversight that is vital to our ongoing success. We do not currently have employment agreements with Mr. Saathoff or any of our engineering staff that prohibit them from competing with us upon termination of their employment. In addition, it may be difficult to replace Mr. Saathoff or engineering staff if one or more of these individuals left the Company. Our business may not be successful if, for any reason, any of these skilled employees ceased to be employees of the Company.

## **ITEM 2. DESCRIPTION OF PROPERTY**

The Company's executive, sales and marketing offices are located in 1,144 square feet of leased office space at 10715 Gulfdale, Suite 200, San Antonio, Texas under a two-year lease agreement that expires in April 2008. The Company leases the space at a monthly rate of \$1,395. The Company's power control products are assembled and tuned in 2,400 square feet of leased office and production space located at 8200 East Pacific Place, Suite 204, Denver, Colorado, for which the Company pays \$1,650 per month. The engineering staff for the set-top box operations is located in 1,500 square feet of leased space for which the Company pays \$1,150 per month. The Company also maintains 230 square feet of space for an engineer in Dallas, Texas for which it pays \$350 per month. Each of these sites outside of San Antonio are on month-to-month leases.

## **ITEM 3. LEGAL PROCEEDINGS**

The Company is not currently involved in any legal proceedings.

## **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a shareholder vote during the period ending December 31, 2007.

**PART II****ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS****(a) Market for Common Equity**

Our common stock trades on the Over the Counter Bulletin Board ("OTCBB") under the symbol "NIHK". Knight Equity Markets, L.P., Olympus Securities, LLC, and UBS Securities LLC are among the most active market makers for the stock.

The following is a table of the high and low bid prices of our stock as of March 31, 2008 and for each of the four quarters of the fiscal years ended December 31, 2007 and 2006:

<b>QUARTER ENDED</b>	<b>HIGH</b>	<b>LOW</b>	<b>QUARTER ENDED</b>	<b>HIGH</b>	<b>LOW</b>
March 31, 2008	\$0.07	\$0.05			
December 31, 2007	0.12	0.07	December 31, 2006	0.10	0.03
September 30, 2007	0.12	0.09	September 30, 2006	0.06	0.03
June 30, 2007	0.20	0.09	June 30, 2006	0.11	0.04
March 31, 2007	0.12	0.06	March 31, 2006	0.16	0.04

These quotations reflect interdealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

**(b) Security Holders**

The number of record holders of our common stock at December 31, 2007 was 171 according to our transfer agent. This figure excludes an indeterminate number of shareholders whose shares are held in "street" or "nominee" name.

**(c) Dividends**

There have been no cash dividends declared or paid on the Company's common stock since the inception of the Company, and no cash dividends are contemplated in the foreseeable future. The Company may consider a potential dividend in the future in either common stock or the stock of future operating subsidiaries. The Company's Series B Preferred Stock provides for an annual dividend equal to 12% of the per share price of each share of Series B Preferred stock, payable quarterly. The dividend is payable in cash or common stock, at the sole option of the holder of the shares. At December 31, 2007, the Company had accumulated \$165,699 in dividends on the Series B Preferred Stock.

(d) Recent Sales of Unregistered Securities

During the first quarter of 2005, the Company sold 650,000 shares of common stock to an investor for cash at a price of \$0.15 per share. Warrants to purchase 650,000 shares of common stock at an exercise price of \$0.25 per share were also included in the sale. We did not publicly offer the securities and the investor is an accredited investor. No underwriters were involved in the sale.

During the second quarter of 2005, the Company sold 100,000 shares of common stock to a business partner of the Company's Chairman for \$20,000. We did not publicly offer the securities and this person is an accredited investor. No underwriters were involved in the sale.

On October 9, 2007, the Company issued 600,000 shares of Series B Convertible Preferred Stock to Dutchess Private Equities Ltd. in return for net cash proceeds of \$5,432,000. The Series B Convertible Preferred is perpetual and non-redeemable, and carries a cumulative annual dividend of 12%, payable quarterly. Each share of Series B Preferred Stock is convertible, at the option of the holder, into shares of Company common stock equal to the greater of (i) \$13.00 worth of common stock based on the lowest closing bid price of the Company's common stock during the twenty trading day period immediately preceding the date of the conversion, or (ii) one hundred shares of common stock.

The securities described immediately above were issued to investors in reliance upon an exemption from the registration requirements of the Securities Act of 1933, as set forth in Section 4(2) under the Securities Act of 1933 and Rule 504, 505 or 506 of Regulation D promulgated thereunder relative to sales by an issuer not involving any public offering, to the extent an exemption from such registration was required. The purchaser of the securities described immediately above this paragraph represented to us in connection with their purchase that they were accredited investors and were acquiring the shares for investment purposes only and not for distribution, that they could bear the risks of the investment and could hold the securities for an indefinite period of time.



The purchasers received written disclosures that the securities had not been registered under the Securities Act of 1933 and that any resale must be made pursuant to a registration statement or an available exemption from such registration. Each participant in the offering or offerings described above was given access to full and complete information regarding us, together with the opportunity to meet with our officers and directors for purposes of asking questions and receiving answers in order to facilitate such participant's independent evaluation of the risks associated with the purchase of our securities.

## **ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION**

### **FORWARD LOOKING STATEMENTS**

Statements in this Annual Report on Form 10-KSB (including the exhibit) that are not purely historical facts, including statements regarding Nighthawk Systems, Inc.'s beliefs, expectations, intentions or strategies for the future, may be "forward-looking statements" under the Private Securities Litigation Reform Act of 1995. All forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially from the plans, intentions and expectations reflected in or suggested by the forward-looking statements. Such risks and uncertainties include, among others, introduction of products in a timely fashion, market acceptance of new products, cost increases, fluctuations in and obsolescence of inventory, price and product competition, availability of labor and materials, development of new third-party products and techniques that render Nighthawk Systems, Inc.'s products obsolete, delays in obtaining regulatory approvals, potential product recalls and litigation. Risk factors, cautionary statements and other conditions which could cause Nighthawk Systems, Inc.'s actual results to differ from management's current expectations are contained in Nighthawk Systems, Inc.'s filings with the Securities and Exchange Commission. Nighthawk Systems, Inc. undertakes no obligation to update any forward-looking statement to reflect events or circumstances that may arise after the date of this filing.

The following information should be read in conjunction with the Company's audited financial statements for the years ended December 31, 2007 and 2006 contained elsewhere in this Annual Report.

### **OVERVIEW**

The Company's financial results include the accounts of Nighthawk Systems, Inc. and its wholly-owned, non-operating subsidiary, Peregrine Control Technologies, Inc. ("PCT"). On October 11, 2007, the Company acquired the assets and assumed certain liabilities of the Set-Top Box business of Eagle Broadband, Inc. for \$4,750,000 in cash. The assets acquired included all accounts receivable, inventory, equipment and intangibles. This acquisition was funded by a \$6.0 million sale of Series B convertible preferred stock and warrants to Dutchess. This acquisition was made primarily to enhance the future cash flows of the Company in an effort to reduce or eliminate monthly operating cash flow deficits.

Nighthawk is a provider of intelligent devices and systems that allow for the centralized, on-demand management of assets and processes. Nighthawk products are used throughout the United States in a variety of mission critical applications, including remotely turning on and off and rebooting devices, activating alarms, and emergency notification, including the display of custom messages. Nighthawk's IPTV set-top boxes are utilized by the hospitality industry to provide in-room standard and high definition television and video on demand.

## COMPARISON OF 2007 AND 2006

### REVENUE

The components of revenue and their associated percentages of total revenues for the fiscal years ended December 31, 2007 and 2006 are as follows:

	Years Ended December 31,					
	2007			2006		
Set-Top Box	\$	510,275	31%	\$	-	-
Utility products		737,736	44%		348,895	39%
General power control products		356,925	22%		509,944	57%
Airtime and access services		50,162	3%		40,336	4%
	\$	1,655,098	100%	\$	899,175	100%

Revenues for 2007 were \$1,655,098 as compared to \$899,175 for the prior year, an increase of 84% between periods.

A large portion of this increase, \$510,275, was produced from sales of IPMediaPro 3000HD set top boxes. With the purchase of the Set-Top Box operation on October 11, 2007, the Company assumed responsibility for the production of approximately 2,050 boxes that has been ordered from Eagle Broadband in prior months. The day after the acquisition was completed, the Company received an additional order from its primary customer for an additional 2,150 units. During the three month period ending December 31, 2007 the Company was able to produce and ship approximately 2,190 set-top box units.