VIALTA INC
Form DEF 14A
May 06, 2004

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OMB APPROVAL	
OMB Number:	3235-0059
Expires:	February 28, 2006
Estimated average burden hours per response	12.75

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x
Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
x Definitive Proxy Statement
o Definitive Additional Materials
o Soliciting Material Pursuant to §240.14a-12

Vialta, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.
o Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

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o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

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3) Filing Party:

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NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held June 15, 2004

TO THE STOCKHOLDERS OF VIALTA, INC.:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of Vialta, Inc. (the Company) will be held on Tuesday, June 15, 2004 at 2:00 p.m., local time, at the Fremont Marriott, 46100 Landing Parkway, Fremont, CA 94538 for the following purposes:

1. To elect six directors of the Company, each to serve until the next Annual Meeting of Stockholders and until his or her successor has been elected and qualified or until his or her earlier resignation or removal.

2. To ratify the selection of PricewaterhouseCoopers LLP as independent accountants for the Company for the fiscal year ending December 31, 2004.

3. To transact such other business as may properly come before the meeting or any postponement or adjournment(s) thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

Only stockholders of record at the close of business on April 23, 2004 are entitled to notice of and to vote at the meeting and any adjournment(s) thereof.

All stockholders are cordially invited to attend the meeting in person. However, to assure your representation at the meeting, you are urged to mark, sign, date and return the enclosed proxy card as promptly as possible in the postage-prepaid envelope enclosed for that purpose. Any stockholder attending the meeting may vote in person even if such stockholder returned a proxy card.

BY ORDER OF THE BOARD OF DIRECTORS

FRED S.L. CHAN
Chairman and Secretary

Fremont, California
May 6, 2004

IMPORTANT

WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY CARD AS PROMPTLY AS POSSIBLE IN THE ENCLOSED POSTAGE-PREPAID ENVELOPE. IF A QUORUM IS NOT REACHED, THE COMPANY MAY HAVE THE ADDED EXPENSE OF RE-ISSUING THESE PROXY MATERIALS. IF YOU ATTEND THE MEETING AND SO DESIRE, YOU MAY WITHDRAW YOUR PROXY AND VOTE IN PERSON. THANK YOU FOR ACTING PROMPTLY.

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VIALTA, INC.

PROXY STATEMENT FOR THE

ANNUAL MEETING OF STOCKHOLDERS
To Be Held June 15, 2004

INFORMATION CONCERNING SOLICITATION AND VOTING

General

The enclosed proxy is solicited by the Board of Directors of Vialta, Inc. (the Company), a Delaware corporation. The Proxy will be used at the Annual Meeting of Stockholders to be held on Tuesday, June 15, 2004 at 2:00 p.m., local time, or at any postponement or adjournment(s) thereof (the Annual Meeting). The Annual Meeting will be held at the Fremont Marriott, 46100 Landing Road, Fremont, CA 94538. The telephone number at that location is (510) 413-3700.

The Company s principal executive offices are located at 48461 Fremont Blvd., Fremont, CA 94538.

Solicitation

These proxy solicitation materials, including an annual report for the fiscal year ended December 31, 2003, will be mailed on or about May 20, 2004 to all stockholders entitled to vote at the Annual Meeting. The costs of soliciting these proxies will be borne by the Company. These costs will include the expenses of preparing and mailing proxy materials for the Annual Meeting and reimbursement paid to brokerage firms and other custodians, nominees and fiduciaries for their expenses incurred in forwarding solicitation material regarding the Annual Meeting to beneficial owners of the Company s Common Stock. Officers, directors and regular employees of the Company may conduct further solicitation personally, telephonically or by facsimile, without receiving additional compensation for assisting with the solicitation.

The Company will provide a copy of the Company s Annual Report on Form 10-K for the year ended December 31, 2003, including financial statements and financial statement schedules (but not exhibits), without charge to each stockholder upon written request. The request should be sent to William Scharninghausen, Chief Financial Officer, Vialta, Inc., 48461 Fremont Blvd., Fremont, CA 94538 (telephone number: (510) 870-3098). Exhibits to the Annual Report may be obtained on written request to Mr. Scharninghausen.

Revocability of Proxies

A proxy may be revoked by the person giving it at any time before its use by submitting to the Secretary of the Company a written notice of revocation, by delivering a duly executed proxy bearing a later date or by attending the Annual Meeting and voting in person. Please note, however, that if a stockholder s shares are held of record by a broker, bank or other nominee and the stockholder wishes to vote at the Annual Meeting, the stockholder must bring to the Annual Meeting a proxy from the broker, bank or other nominee authorizing him or her to vote the shares.

VOTING RIGHTS AND SOLICITATION OF PROXIES

Voting

Each share of Vialta common stock outstanding on the record date is entitled to one vote per share on all matters. In accordance with the provisions of California law, until the Company is a listed corporation

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stockholders have the right to cumulate votes in connection with the election of directors. Each stockholder complying with the conditions set forth below may cumulate votes and give one candidate a number of votes equal to the number of votes to which such stockholder s shares are entitled multiplied by the number of directors to be elected. The stockholder may cast these votes all for a single candidate or distribute the votes among any or all of the candidates. Under California law, no stockholder will be entitled to cumulate votes for a candidate unless that candidate s name has been placed in nomination prior to the voting and the stockholder, or any other stockholder, has given notice at the Annual Meeting prior to the voting of an intention to cumulate votes. In such event, the proxy holder may allocate among the Board of Directors nominees the votes represented by proxies in the proxy holder s sole discretion. With respect to the election of directors, the six directors receiving the highest number of votes of the shares of Common Stock present in person or represented by proxy at the Annual Meeting and voting on the election of directors will be elected.

The Inspector of Elections will tabulate the votes cast in person or by proxy at the Annual Meeting. The affirmative vote of a majority of the votes cast at a duly held meeting at which a quorum is present and voting is required for approval of proposals presented to stockholders other than the election of directors. If a broker indicates on the enclosed proxy or its substitute that it does not have discretionary authority as to certain shares to vote on a particular matter (broker non-votes), those shares will not be considered as votes present with respect to that matter so will have no effect on the outcome of that vote. Abstentions will not be counted in the tabulation of the voting results with respect to the election of directors but will have the effect of a negative vote on the other proposals.

Quorum

A majority of the outstanding shares on the record date, represented either in person or by proxy, shall constitute a quorum for purposes of the Annual Meeting. The Inspector of Elections will determine whether or not a quorum is present. The Inspector of Elections will treat abstentions and broker non-votes as shares that are present and entitled to vote for purposes of determining the presence of a quorum.

Board Recommendations

Any proxy which is returned using the form of proxy enclosed and which is not marked as to a particular item will be voted, as applicable, for the election of the Board s nominees for directors, for the ratification of PricewaterhouseCooper, LLP, and as the proxy holders deem advisable on other matters that may come before the meeting.

Record Date and Share Ownership

Only stockholders of record at the close of business on April 23, 2004 are entitled to notice of and to vote at the Annual Meeting. As of the record date, 82,865,712 shares of the Company s Common Stock were issued and outstanding, and there were 417 stockholders of record.

Deadline for Receipt of Stockholder Proposals

Under our bylaws, no business may be brought before an annual meeting unless it is specified in the notice of the meeting or is otherwise properly brought before the meeting by or at the direction of the Board or by an eligible stockholder who has delivered written notice to the Company s Corporate Secretary not less than 120 days prior to the date that the Company s proxy statement was released to stockholders in connection with the previous year s annual meeting of stockholders. With respect to the Company s 2005 Annual Meeting of Stockholders, written proposals by stockholders of the Company must be received by the Company no later than December 31, 2004 to be considered for inclusion in the proxy statement and form of proxy relating to that meeting. If the date of the Company s 2005 Annual Meeting of Stockholders is changed by more than 30 calendar days from the date contemplated, notice by the stockholder must be received not later than the close of business on the tenth day following the day on which the date of the annual meeting is publicly announced.

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PROPOSAL NO. 1

ELECTION OF DIRECTORS

The Company s bylaws currently provide that the number of directors shall be fixed from time to time by the Board of Directors. The size of the Board of Directors is currently set at six members. The Company s bylaws divides the Board into three classes with staggered, three-year terms. Herbert Chang and George M. Cain serve as Class I directors, with terms set to expire in 2005. Matthew K. Fong and Didier Pietri serve as Class II directors with terms set to expire in 2006, and Fred S.L. Chan and Michael S. Dubester serve as Class III directors, with terms set to expire in 2004. However, pursuant to the requirements of California law, this provision will become effective only when the Company becomes a listed corporation, as defined under California law. As a result, six nominees will be elected at the Annual Meeting to be the six directors of the Company.

The Board has nominated the six people named below to serve as directors to hold office until the next Annual Meeting of Stockholders and until their respective successors have been elected and qualified or until such directors earlier resignation or removal. All of the nominees are currently directors of the Company. If any nominee, for any reason, is unable to, or will not, serve as a director, the proxies may be voted for and will serve in the same class as designated above such substitute nominee as the proxy holder may determine. The Company is not aware of any nominee who will be unable to, or will not serve as a director.

Director

The names of the nominees, and certain information about them as of March 31, 2004, are set forth below:

Name of Nominee	Age	Position(s) with Vialta	Director Since
Fred S.L. Chan	57	Chairman of the Board	1999
Didier Pietri	41	President, Chief Executive Officer and Director	2001
George M. Cain	59	Director	2003
Herbert Chang	41	Director	1999
Michael S. Dubester	56	Director	2003
Matthew K. Fong	50	Director	1999

Fred S. L. Chan has served as the Company s Chairman of the Board of Directors since the Company s inception in 1999. He also served as the Company s President from its inception through April 2001 and as Chief Executive Officer from its inception through August 2001. Prior to joining the Company, Mr. Chan founded and held various executive positions at ESS Technology, Inc., a designer, developer and marketer of highly integrated digital system processor chips, since 1986, as well as being Chairman of the Board, in which capacity he still serves.

Didier Pietri has been a member of Vialta s board of directors since September 2001. Mr. Pietri joined the Company in April 2001 as its President and in August 2001 also became its Chief Executive Officer. Prior to joining Vialta, Mr. Pietri served as President and Chief Executive Officer of TVA/ Motion International, a global entertainment production and distribution company from August 1999 to March 2001. From June 1995 to July 1999, Mr. Pietri was Senior Vice President of the ABC Television Network Group, as well as President of ABC Pictures, a division of The Walt Disney Company.

George M. Cain has been a member of Vialta s board of directors since February 2003. Mr. Cain is the founder and President of C3 Media & Marketing Group, LLC, a media marketing consulting company. He has held that position since 1996. Mr. Cain is also the founder and CEO of Strategic Media & Marketing Group, LLC, a marketing and sales company which has assisted a German enterprise software company with the introduction of its products in North America. He has held that position since 2001.

Herbert Chang has been a member of Vialta s board of directors since November 1999. Mr. Chang is the President of InveStar Capital, Inc., a venture capital firm. He has held that position since August 1996. In addition, Mr. Chang is the managing member of Forefront Associates, LLC, which is the general partner of Forefront Venture Partners, L.P., a position he has held since February 1998. Mr. Chang currently serves as a director of Marvell Technology Group Ltd. and Oplink Communications, Inc.

Michael S. Dubester has been a member of Vialta s board of directors since February 2003. Mr. Dubester is the Senior Vice President of Business Development of Vulcan Sports Media, Inc., a U.S. sports media company whose principal business is The Sporting News. He has held that position since 2000. Prior to that, Mr. Dubester served as the President of Times Mirror Interzines, the online network of Internet sites affiliated with Times Mirror Magazine titles, the previous owner of The Sporting News, from 1998 until 2000. He was the founder and President of The Sporting News Online, from 1996 until 1998.

Matthew K. Fong has been a member of Vialta s board of directors since April 1999. Mr. Fong was employed by the Company from September 2001 through January 31, 2003, as an Advisor to the Chairman of the Board. In addition, since February 1999, Mr. Fong has been an attorney with the law firm of Sheppard, Mullin, Richter & Hampton, LLP and the Chief Executive Officer of Strategic Advisory Group, a financial and high technology consulting group that he founded. Prior to that, Mr. Fong served as California State Treasurer from January 1995 to January 1999.

Board of Directors Meetings and Committees

The Board of Directors met four times during fiscal year 2003. The Board of Directors, during 2003, had an Audit Committee and a Compensation Committee but did not have a Nominating Committee or any other standing committees. Nominations to the Board of Directors are handled as discussed below. Each incumbent director attended at least 75% of the meetings of the Board and meetings of the Committees of the Board on which he served during the fiscal year 2003. The Company invites Board members to attend annual meetings of the stockholders. Didier Pietri attended the last annual meeting of stockholders.

Audit Committee. The Audit Committee is currently comprised of three members: Matthew Fong (Chairman), Michael Dubester and Herbert Chang. Mr. Dubester was elected to the Audit Committee on May 1, 2003. Mr. Chang was elected to the Audit Committee on April 23, 2002. Currently, Mr. Chang and Mr. Dubester are both independent as defined by the listing standard of NASDAQ as now in effect. Prior to January 31, 2003, Mr. Fong was employed by the Company as the Advisor to the Chairman so is not independent under such standard. During 2003, the Board did not designate any member as a financial expert within the meaning of applicable regulatory standards, but believes that each member has the appropriate experience and ability to perform their duties as Audit Committee members.

The Audit Committee pre-approves the performance of audit and non-audit services by the Company s accountants and reviews the Company s internal control systems, financial reporting procedures, the general scope of the Company s annual audit, the fees charged by the independent accountants, and the fairness of any proposed transaction between any officer, director or other affiliate of the Company and the Company. With respect to the foregoing, the Audit Committee makes recommendations to the full Board and performs such further functions as may be required or delegated to the Committee by the Board of Directors. The Board of Directors has adopted a written charter for the Audit Committee, a copy of which is attached to the Proxy Statement filed by the Company on April 30, 2002. During fiscal year 2003, the Audit Committee of the Board held four meetings independent of the entire Board of Directors.

Compensation Committee. The Compensation Committee is comprised of three members: Matthew Fong (Chairman), George Cain and Michael Dubester. The Compensation Committee reviews and approves compensation and benefits for the Company s key executive officers, administers the Company s stock purchase and equity incentive plans and makes recommendations to the Board of Directors regarding such matters. During fiscal year 2003, the Compensation Committee held two meetings independent of the entire Board of Directors.

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Nominations. The Company does not have a nominating committee. In light of the relatively small size of the Board of Directors, the Company does not believe that a separate nominating committee is currently necessary. In the interim, all current directors will take part, as necessary, in selecting any required nominees. The Board currently considers candidates for Board membership suggested by its members. A stockholder who wishes to recommend a prospective nominee for the Board should notify the Company s Corporate Secretary in writing with whatever supporting material the stockholder considers appropriate. The Board will also consider whether to nominate any person nominated by a stockholder pursuant to the provisions of the Company s bylaws relating to stockholder nominations.

Compensation of Directors

During 2003, non-employee directors of the Company received cash compensation for their services, along with reimbursement for their reasonable expenses in attending meetings of the Board of Directors or any meetings of a Committee of the Board of Directors. Commencing with the first quarter of 2003, each non-employee director received the following fees:

- $2,000 for each Board meeting attended in person;
- $1,000 for each Board meeting attended by telephone;
- $8,000 per year for service on the Audit Committee or $12,000 per year for service as the Chairman of the Audit Committee, in each case payable in four quarterly installments; and
- an annual stock grant of 20,000 shares under our 2000 Directors Stock Option Plan, as amended on April 30, 2003. Prior to its amendment, the 2000 Directors Stock Option Plan provided for an initial grant of 32,000 shares and subsequent grants of 8,000 shares each year for services as a director. All options are granted at an exercise price equal to the fair market value of a share of Common Stock on the date of grant and vest in four equal annual installments, starting on the first anniversary of the date of grant. For a more detailed description of the Directors Plan, including the amendment, see Exhibit 10.2 of the Company s 2003 Form 10-K for the 2003 fiscal year filed with the SEC.

Up until January 2003, Mr. Fong served as an advisor to the Chairman of the Board and received $8,025 in 2003 as compensation for advisory services provided to the Company. Subsequent to January 2003, Mr. Fong, as a non-employee director, received $20,000 for Board and committee meetings attended in 2003. Mr. Cain received $8,000; Mr. Chang received $10,000, and Mr. Dubester received $13,000 for Board and committee meetings attended in 2003.

Directors who are employees of the Company do not receive additional compensation for their services as directors. During fiscal 2003, Mr. Chan and Mr. Pietri were the only employees who served as directors.

Communications with the Board

Stockholders who wish to communicate with a member or members of the Board of Directors, or the non-employee directors as a group, may do so by addressing their correspondence to the Board member or members, c/o Vialta s Corporate Secretary at the principal executive office of the Company, with a request to forward the same to the intended recipient. In general, all stockholder communications delivered to Vialta s Corporate Secretary for forwarding to the Board or specified Board members will be forwarded in accordance with the stockholder s instructions.

Required Vote

The six nominees receiving the highest number of affirmative votes of shares of the Company s Common Stock present at the Annual Meeting in person or by proxy and voting on the election of directors shall be elected as directors.

THE BOARD RECOMMENDS A VOTE FOR THE ELECTION

OF EACH OF THE NOMINEES LISTED ABOVE.

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PROPOSAL NO. 2

RATIFICATION OF SELECTION OF INDEPENDENT ACCOUNTANTS

The Company has selected PricewaterhouseCoopers LLP (PwC) as its independent accountants to perform the audit of the Company s financial statements for fiscal year 2004 and recommends that the stockholders ratify such selection. In the event the stockholders do not ratify such appointment, the Board will reconsider its selection. PwC has been the Company s independent accountants since August 2001 when the Company was spun off from its parent. Even if the appointment is ratified, the Audit Committee may recommend to the Board or the Board may appoint a different firm at any time if it determines that such appointment is in the best interests of the Company. Representatives of PwC are expected to be present at the Annual Meeting, will have the opportunity to make a statement at the Annual Meeting if they desire to do so and are expected to be available to respond to appropriate questions.

Fees Paid to the Independent Accountants

The aggregate fees for professional services by PwC for fiscal 2003 and 2002 are listed in the following table.

	Fiscal 2003	Fiscal 2002	Description
Audit Fees	$208,000	$227,000	Services rendered for the annual audit and quarterly reviews of the Company s financial statements.
Audit Related Fees	0	0	
Tax Fees	40,900	60,000	Tax compliance and preparation
All Other Fees	0	0	
	$248,900	$287,000	

The Audit Committee of the Board pre-approved all non-audit services provided by PwC and concluded, based on information provided by PwC, that providing such services is compatible with maintaining PwC s independence.

Required Vote

The ratification of the appointment of PricewaterhouseCoopers LLP as the Company s independent accountants requires the affirmative vote of the holders of a majority of the shares of the Company s Common Stock present at the Annual Meeting in person or by proxy and entitled to vote.

THE BOARD RECOMMENDS A VOTE FOR THE RATIFICATION OF THE SELECTION OF

PRICEWATERHOUSECOOPERS LLP FOR FISCAL YEAR 2003.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information, as of March 31, 2004, known to the Company regarding the beneficial ownership of the Company s Common Stock by (i) each person known by the Company to be the beneficial owner of more than 5% of the Company s Common Stock, (ii) each of the Company s directors, (iii) each executive officer named in the Summary Compensation Table below (the Named Executive Officers) and (iv) all directors and executive officers as a group. Unless otherwise indicated in the footnotes hereto, each director and executive officer has (or could have upon exercise of an

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option vested or vesting within 60 days of March 31, 2004) sole vesting and investment power, subject to community property laws where applicable.

Name and Address of Beneficial Owners(1)	Common Stock Beneficially Owned Number	Percent
State of Wisconsin Investment Board(2) P.O. Box 7842, Madison, WI 53707	7,892,600	10%
Trusts for the Benefit of the children of Fred S.L. Chan(3)	11,083,757	13%
Fred S.L. Chan(4)	21,495,863	26%
Didier Pietri(5)	2,496,936	2%
George M. Cain(6)	5,000	*
Herbert Chang(7)	33,833	*
Matthew K. Fong	80,974	*
Michael S. Dubester(8)	5,000	*
William Scharninghausen(9)	62,500	*
All executive officers and directors as a group (7 persons)	24,180,106	29%

* Less than 1% of the outstanding shares of the Company s Common Stock.

(1) Unless otherwise indicated, the address for each beneficial owner is c/o Vialta, Inc., 48461 Fremont Boulevard, Fremont, CA 94538.

(2) Based on a filing with the Securities Exchange Commission on February 16, 2004 indicating beneficial ownership as of December 31, 2003.

(3) Includes shares held by trusts for the benefit of the children of Mr. and Mrs. Chan. Includes 8,800,000 shares held by Evershine XVI, L.P., an entity controlled by a trust for the benefit of Mr. Chan s children.

(4) Includes 539,780 shares which Mr. Chan has the right to acquire on or within 60 days of March 31, 2004 through the exercise of options.

(5) Includes 2,437,500 shares which Mr. Pietri has the right to acquire on or within 60 days of March 31, 2004 through the exercise of options.

(6) Includes 5,000 shares which Mr. Cain has the right to acquire on or within 60 days of March 31, 2004 through the exercise of options.

(7) Includes 33,833 shares which Mr. Chang has the right to acquire on or within 60 days of March 31, 2004 through the exercise of options.

(8) Includes 5,000 shares which Mr. Dubester has the right to acquire on or within 60 days of March 31, 2004 through the exercise of options.

(9) Includes 62,500 shares which Mr. Scharninghausen has the right to acquire on or within 60 days of March 31, 2004 through the exercise of options.

EXECUTIVE OFFICERS

Certain information about William Scharninghausen, an executive officer of the Company is set forth below. Information about Messrs. Chan and Pietri is set forth above in Proposal No. 1 Election of Directors.

William M. Scharninghausen, 47, has been Chief Financial Officer of the Company since October 2002. Prior to joining Vialta, he was the Chief Financial Officer of Diva Systems, Inc., a video on demand technology company, from January 1999 to September 2002. He also served as the Senior Vice President of Finance and Administration of Diva Systems, Inc. from June 1997 to September 2002. As part of Gemstar-TV Guide International, Inc. s proposed purchase of Diva s assets, Diva filed a Chapter 11

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bankruptcy petition and pre-negotiated plan of reorganization on May 29, 2002 in the Northern District of California.

EXECUTIVE COMPENSATION

The following table sets forth the compensation earned by the Named Executive Officers: (1) the Company s Chief Executive Officer and (2) the Company s four other most highly compensated executive officers for the fiscal year 2003.

Summary Compensation Table

		Annual Compensation			Long-Term Compensation Awards	
Name and Principal Position	**Fiscal Year**	**Salary**	**Bonus**	**Other Annual Compensation(1)**	**Securities Underlying Options**	**All Other Compensation(2)**
Fred S.L. Chan(3)	2003	$252,762	$			$175
Chairman of the Board of	2002	248,000				950
Directors	2001	248,000				966
Didier Pietri(4)	2003	$310,663	$150,000		2,000,000	$175
President and Chief	2002	300,000	175,000(5)			950
Executive Officer	2001	188,636			2,000,000	252
William M. Scharninghausen(6)	2003	$183,729			15,000	$175
Chief Financial Officer	2002	28,038			250,000	86
	2001					

(1) In accordance with SEC rules, perquisites and personal benefits have been omitted because such benefits, if any, did not exceed the reporting thresholds under SEC rules.

(2) Includes dollar value of premiums paid by the Company under the Company s long term disability policy on behalf of the Named Executive Officers.

(3) Mr. Chan was President of the Company from its inception through April 2001 and was its Chief Executive Officer from its inception through August 28, 2001.

(4) Mr. Pietri joined the Company as President on April 30, 2001 and became Chief Executive Officer on August 29, 2001.

(5) Includes $75,000 earned in 2002 that was deferred, at Mr. Pietri s election, to 2003.

(6) Mr. Scharninghausen joined the Company as Chief Financial Officer on October 16, 2002

OPTION GRANTS IN LAST FISCAL YEAR

	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock for Price Appreciation Option Term	
Name	**Number of Securities Underlying Options Gramted**	**Percent of Total Options Granted to Employees in Fiscal Year**	**Exercise Price**	**Expiration Date**	**5%**	**10%**
Fred S. L. Chan		0%				

Didier Pietri(1)	2,000,000	83%	$0.34	6/5/13	$1,230,800	$1,564,000
William M. Scharninghausen(1)	15,000	1%	0.50	7/1/13	13,575	17,250

(1) Options vest at a rate of 25% on each of the one and two year anniversary of grant and 1/48 on each one month anniversary thereafter.

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AGGREGATE OPTIONS EXERCISES IN LAST FISCAL YEAR AND

FISCAL YEAR-END VALUES

The following table sets forth certain information concerning the exercise of options by each of the Named Executive Officers during fiscal year 2003, including the aggregate amount of gains on the date of exercise. In addition, the table includes the number of shares covered by both exercisable and unexercisable stock options as of December 31, 2003.

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at Fiscal Year End		Value of Unexercised In-The-Money Options at Fiscal Year-End(1)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Fred S.L. Chan	0	$ 0	515,155	1,182,225	$278,184	$363,402
Didier Pietri	0	$ 0	1,750,000	2,250,000	170,000	350,000
William M. Scharninghausen	0	$ 0	62,500	202,500	2,500	10,650

(1) Valuation of these options is based on the closing bid price of $0.54 per share, as quoted on the over the counter bulletin board on December 31, 2003.

EMPLOYMENT AGREEMENTS

Didier Pietri originally entered into an employment letter agreement on April 2001, with the Company pursuant to which he was entitled to receive an annual salary of $300,000. In addition to basic compensation, Mr. Pietri was entitled to participation in employee benefit plans, stock option grants and a guaranteed bonus of $100,000 after one year of service. Mr. Pietri was also awarded an additional $150,000 bonus, which was paid in 2003. In April 2002, the Compensation Committee approved continuing Mr. Pietri s basic compensation at the previous rate, but his the guaranteed bonus for his second year of service was reduced to $75,000, and a discretionary bonus of $75,000 was added. Any discretionary bonus must be paid before the expiration of the agreement. In May, 2003, the Compensation Committee again approved continuing Mr. Pietri s base salary and retaining his guaranteed and discretionary bonuses. In addition, the compensation committee approved a stock option grant to Mr. Pietri of 2,000,000 shares of common stock to vest 25% immediately, 25% on the first anniversary of the grant and 2 1/2% each month thereafter.

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PERFORMANCE GRAPH

The graph below compares the cumulative total stockholder return on the Common Stock of the Company from the first day of trading of the Company s Common Stock after the Company s spin-off from ESS Technology, Inc. (August 21, 2001) to December 31, 2003 with the cumulative total return on the NASDAQ Stock Market Index and the Dow Jones Consumer Electronics Industry Index (assuming the investment of $100 in the Company s Common Stock and in each of the indexes on the date of the Company s initial public offering, and reinvestment of all dividends). The stock price performance on the following graph is not necessarily indicative of future stock price performance.

Stock Price Performance

August 23 (Inception), 2001 December 31, 2003

The following description data are supplied in accordance with Rule 304(d) of Regulation S-T:

	Vialta, Inc.	NASDAQ Composite	Dow Jones Consumer Electronics Index
Date	Investment Value	Investment Value	Investment Value
8/23/01	$100.00	$100.00	$100.00
12/31/01	$263.83	$ 81.94	$112.05
12/31/02	$ 64.89	$ 75.35	$138.89
12/31/03	$114.89	$106.18	$345.82

Notwithstanding anything to the contrary set forth in any of the Company s previous filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate future filings, including this Proxy Statement, in whole or in part, the following and the Performance Graph in this proxy shall not be incorporated by reference into any such filing.

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REPORT OF THE AUDIT COMMITTEE

The Company s management has the primary responsibility for the integrity of the Company s financial information. The Company s independent accountants are responsible for conducting independent audits of the Company s financial statements in accordance with generally accepted auditing standards and expressing an opinion on the financial statements based on those audits. The Audit Committee nominates the independent accountants for approval by the Board and is responsible for overseeing the conduct of the above activities by management and such accountants.

As part of its responsibility, the Audit Committee has met with the Company s independent accountants to review and discuss the adequacy of the Company s internal control system, financial reporting procedures and other matters required to be discussed by the Statement of Auditor Standards 61 such as the independent accountant s judgments as to the quality of the financial statements, changes in the accounting policies and sensitive accounting estimates. The Audit Committee has reviewed and discussed the audited financial statements with management and the Company s independent accountants. The Audit Committee preapproved the general scope of the Company s annual audit and performance of non-audit services by the Company s accountants and reviewed the fees charged by the independent accountants. The Audit Committee has received the written disclosures and the letter from the independent accountants required by Independent Standards Board Standard No. 1 and has discussed with the independent accountants that firm s independence.

Based upon these reviews and discussions, the Audit Committee recommended to the Board that the audited financial statement be included in the Company s annual report on Form 10-K for the year ended December 31, 2003.

AUDIT COMMITTEE

/s/ MATT FONG

/s/ HERBERT CHANG

/s/ MICHAEL DUBESTER

REPORT OF THE COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION

General

The Committee acts on behalf of the Board to examine and implement the general compensation policy of the Company for all executive officers and such other employees of the Company as the Board of Directors may deem appropriate. The Committee reviews the general compensation policy applicable to the Chief Executive Officer (CEO) and other executive officers on an annual basis. The Committee administers the Company s incentive and equity plans, including the 1999 Stock Incentive Plan, the 2000 Directors Stock Option Plan and the 2001 Nonstatutory Stock Option Plan.

The Company s policy in compensating its executive officers is intended to attract, motivate and retain these executives. Consistent with this policy, key executives are eligible to receive, in addition to their base salaries, stock option grants under the 1999 Stock Incentive Plan in amounts determined by the Board of Directors based on recommendations by the Compensation Committee. Stock options have value for these executives only if the price of the Company s stock increases above the fair market value on the grant date and the executive remains in the Company s employ for the period required for the shares to vest. Additional incentive compensation is also considered by the Committee based on individual performance and the achievement of short term goals.

The base salary, incentive compensation and stock option grants of the executive officers are determined in part by the Committee reviewing data on prevailing compensation practices in technology companies with

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whom the Company competes for executive talent and by their evaluating such information in connection with the Company s corporate goals. To this end, the Committee attempts to compare the compensation of the Company s CEO and other executive officers with the compensation practices of comparable companies to determine base salary, target bonuses and target total cash compensation.

Compensation of Executive Officers

During the fiscal year that ended on December 31, 2003, the Company s executive compensation program was comprised of the following key components: base salary, annual bonus, and equity-based incentives.

Base Salary. The Company sets the base salaries of its executives at levels believed to be consistent with comparably sized companies engaged in similar industries.

Equity-Based Incentive Compensation. Stock options are an important component of the total compensation of executives. The Company believes that stock options align the interests of each executive with those of the stockholders. They also provide executives a significant, long-term interest in the Company s success and help retain key executives in a competitive market for executive talent. The Company s 1999 Equity Incentive Plan authorizes the Committee to grant stock options to executives. The number of shares owned by, or subject to options held by, each executive officer is periodically reviewed and additional awards are considered based upon past performance of the executive and the relative holdings of other executives in the Company. The option grants generally utilize four-year vesting periods to encourage executives to continue contributing to the Company, and they expire not later than ten years from the date of grant.

Compensation of the Chief Executive Officer

The Company s CEO s compensation plans include the same elements and performance measures as the plans of the Company s other executive officers. The Compensation Committee evaluates the performance of the Company s CEO, sets his base compensation and determines bonuses and awards stock or option grants, if any. In May 2003 the Compensation Committee approved continuing Mr. Pietri s basic compensation at the rate he has been paid since joining the Company in April of 2001. In addition, the Compensation Committee voted to provide a guaranteed bonus of $75,000, which was paid in November 2003. A discretionary bonus of $75,000 has not yet been paid as of the date of this proxy statement filing. The Compensation Committee also approved a stock option grant to Mr. Pietri of 2,000,000 shares of common stock to vest 25% immediately, 25% on the first anniversary of the grant and 2 1/2% each month thereafter. In determining the terms of his agreement, the Compensation Committee considered a number of factors and criteria including, Mr. Pietri s depth of experience, his past accomplishments with other companies, his vision and leadership abilities, and the future needs of the Company. In making its compensation decisions with Mr. Pietri, the Compensation Committee also considered the need to provide continuity of leadership. The Compensation Committee exercised its discretion and judgment based on the above factors, and no specific formula was applied to determine the weight of any factor.

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Deductibility of Executive Compensation

The Compensation Committee has considered the impact of Section 162(m) of the Code, which disallows a deduction for any publicly held corporation for individual compensation exceeding $1 million in any taxable year for the CEO and four other most highly compensated executive officers, unless such compensation meets the requirements for the performance-based exception to the general rule. Since the cash compensation paid by the Company to each of its executive officers is expected to be below $1 million, the Compensation Committee believes that this section will not affect the tax deductions available to the Company. It will be the Compensation Committee s policy to qualify, to the extent reasonable, the executive officers compensation for deductibility under applicable tax law.

COMPENSATION COMMITTEE

/s/ MATT FONG

/s/ GEORGE CAIN

/s/ MICHAEL DUBESTER

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

Fred Chan, who is the Chairman of the Company, participated in deliberations of the Company s Board of Directors concerning executive officer compensation.

Vialta employs Fred S.L. Chan s brother as its Senior Director of IT and one of his sons as its Director of Product Marketing and Design. The salary and benefits provided to these individualsdth="1%" style="TEXT-ALIGN: left">

Costs and expenses:

Cost of hardware sales	1,902	-
Cost of services	463	197
Research and development	1,279	973
Selling and marketing	858	876
General and administrative	804	731
Total cost and expenses	5,306	2,777
Operating income before patent related income	1,311	2,201
Income from patent arrangement	-	780
Operating income after patent related income	1,311	2,981
Interest income	86	82
Income from continuing operations before income taxes	1,397	3,063
Provision for income taxes	517	1,091
Income from continuing operations	880	1,972
Loss from discontinued operations, net of income taxes	-	(115)
Net income	$880	$1,857

Basic net income per share:		
Basic net income per share from continuing operations	$0.04	$0.09
Basic net loss per share from discontinued operations	-	(0.01)
Basic net income per share	$0.04	$0.08
Diluted net income per share:		
Diluted net income per share from continuing operations	$0.04	$0.09
Diluted net loss per share from discontinued operations	-	(0.01)
Diluted net income per share	$0.04	$0.08
Weighted-average shares – basic	22,626	22,511
Weighted-average shares - diluted	22,699	22,564
Comprehensive income:		
Net income	$880	$1,857
Other comprehensive income (net of tax):		
Unrealized gains on available for sale securities	84	58
Comprehensive income	$964	$1,915

The accompanying notes are an integral part of the consolidated financial statements.

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AWARE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Cash flows from operating activities:		
Net income	$880	$1,857
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	132	107
Stock-based compensation	29	10
Amortization of premium on investments	2	5
Deferred tax provision on other comprehensive income	(60)	-
Changes in assets and liabilities:		
Accounts receivable	(11)	(1,592)
Receivable from patent arrangement	-	341
Inventories	1,600	-
Prepaid expenses and other current assets	(82)	(40)
Deferred tax assets	89	150
Accounts payable	(1,311)	(156)
Accrued expenses, compensation, and professional	(56)	(180)
Deferred revenue	(4)	143
Net cash provided by operating activities	1,208	645
Cash flows from investing activities:		
Purchases of property and equipment	(11)	(70)
Net cash used in investing activities	(11)	(70)
Cash flows from financing activities:		
Proceeds from issuance of common stock	9	20
Excess tax benefits from stock-based compensation	594	838
Payments made for taxes of employees who surrendered shares related to unrestricted stock	(92)	-
Net cash provided by financing activities	511	858
Increase in cash and cash equivalents	1,708	1,433
Cash and cash equivalents, beginning of period	72,660	71,074
Cash and cash equivalents, end of period	$74,368	$72,507
Supplemental disclosure:	$2	$63

Cash paid for income taxes

The accompanying notes are an integral part of the consolidated financial statements.

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AWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

A) Basis of Presentation. The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and therefore do not include all information and notes necessary for a complete presentation of our financial position, results of operations and cash flows, in conformity with generally accepted accounting principles. We filed audited financial statements which included all information and notes necessary for such presentation for the three years ended December 31, 2013 in conjunction with our 2013 Annual Report on Form 10-K. This Form 10-Q should be read in conjunction with that Form 10-K.

The accompanying unaudited consolidated balance sheets, statements of income and comprehensive income, and statements of cash flows reflect all adjustments (consisting only of normal recurring items) which are, in the opinion of management, necessary for a fair presentation of financial position at March 31, 2014, and of operations and cash flows for the interim periods ended March 31, 2014 and 2013.

The results of operations for the interim period ended March 31, 2014 are not necessarily indicative of the results to be expected for the year.

B) Fair Value Measurements. The Financial Accounting Standards Board ("FASB") Codification defines fair value, and establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to the unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under the FASB Codification are: i) Level 1 – valuations that are based on quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date; ii) Level 2 – valuations that are based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly; and iii) Level 3 – valuations that require inputs that are both significant to the fair value measurement and unobservable.

Cash and cash equivalents, which primarily include money market mutual funds, were $74.4 million and $72.7 million as of March 31, 2014 and December 31, 2013, respectively. We classified our cash equivalents of $68.6 million as of March 31, 2014 and December 31, 2013 within Level 1 of the fair value hierarchy because they are valued using quoted market prices.

Our investments, which consist of high yield corporate debt securities, are also classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. We categorize our investments as available-for-sale securities, and carry them at fair value in our financial statements. We had $2.9 million and $2.8 million of available-for-sale investments as of March 31, 2014 and December 31, 2013, respectively.

As of March 31, 2014, our assets that are measured at fair value on a recurring basis and whose carrying values approximate their respective fair values include the following (in thousands):

	Fair Value Measurement at March 31, 2014 Using:		
	Quoted Prices in Active	Significant Other Observable Inputs	Significant Unobservable Inputs

	Markets for Identical Assets (Level 1)	(Level 2)	(Level 3)
Corporate debt securities	$2,896	$ -	$ -
Money market funds (included in cash and cash equivalents)	68,641		
Total	$71,537	$ -	$ -

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As of December 31, 2013, our assets that are measured at fair value on a recurring basis and whose carrying values approximate their respective fair values include the following (in thousands):

	Fair Value Measurement at December 31, 2013 Using:		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Corporate debt securities	$2,754	$ -	$ -
Money market funds (included in cash and cash equivalents)	68,556		
Total	$71,310	$ -	$ -

C) Inventories. Inventories are stated at the lower of cost or net realizable value with cost being determined by the first-in, first-out ("FIFO") method. Inventories consisted of the following (in thousands):

	March 31, 2014	December 31, 2013
Raw materials	$ 1	$ 1,584
Finished goods	-	17
Total	$ 1	$ 1,601

D) Computation of Earnings per Share. Basic earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding plus additional common shares that would have been outstanding if dilutive potential common shares had been issued. For the purposes of this calculation, stock options are considered common stock equivalents in periods in which they have a dilutive effect. Stock options that are anti-dilutive are excluded from the calculation.

Net income per share is calculated as follows (in thousands, except per share data):

	Three Months Ended March 31,	
	2014	2013
Net income:		
Income from continuing operations	$880	$1,972
Loss from discontinued operations	-	(115)
Net income	$880	$1,857
Shares outstanding:		
Weighted-average common shares outstanding	22,626	22,511
	73	53

Additional dilutive common stock equivalents		
Diluted shares outstanding	22,699	22,564
Basic net income per share:		
Basic net income per share from continuing operations	$0.04	$0.09
Basic net loss per share from discontinued operations	-	(0.01)
Basic net income per share	$0.04	$0.08
Diluted net income per share:		
Diluted net income per share from continuing operations	$0.04	$0.09
Diluted net loss per share from discontinued operations	-	(0.01)
Diluted net income per share	$0.04	$0.08

For the three month periods ended March 31, 2014 and 2013, options to purchase 821,838 shares of common stock were outstanding, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common stock and thus would be anti-dilutive.

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E) Stock-Based Compensation. The following table presents stock-based employee compensation expenses included in our unaudited consolidated statements of comprehensive income (in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Cost of services	$ 1	$ -
Research and development	2	-
Selling and marketing	1	-
General and administrative	25	10
Stock-based compensation expense	$ 29	$ 10

Stock Option and SAR Grants. We grant stock options and stock appreciation rights ("SARs") under our 2001 Nonqualified Stock Plan. We estimate the fair value of stock options and SARs using the Black-Scholes valuation model. This valuation model takes into account the exercise price of the award, as well as a variety of significant assumptions. The assumptions used to estimate the fair value of stock options and SARs include the expected term, the expected volatility of our stock over the expected term, the risk-free interest rate over the expected term, and our expected annual dividend yield. We believe that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of our stock options and SARs. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

Unrestricted Stock Grants. We also grant unrestricted shares of stock under our 2001 Nonqualified Stock Plan. Stock-based compensation expense for stock grants is determined based on the fair market value of our stock on the date of grant, provided the number of shares in the grant is fixed on the grant date.

Stock Option and SAR Grant Activity. We did not grant any stock options or SARs in the three month periods ended March 31, 2014 and 2013.

Unrestricted Stock Grant Activity. We granted shares of unrestricted stock in 2014 and 2013 that affected financial results for the three months ended March 31, 2014 and 2013. These grants are described below.

2014 Grant. On March 26, 2014, we granted 152,000 shares of unrestricted stock to directors, officers and employees. The shares will be issued in two equal installments shortly after June 30, 2014 and December 31, 2014, provided each grantee is serving as a director, officer or employee on those dates. The total stock-based compensation expense related to this grant is $876,000, of which $19,000 was charged to expense in the three months ended March 31, 2014 and we anticipate the remaining $857,000 will be charged to expense ratably over the remaining three quarters of 2014.

2013 Grant. In April 2013, we granted 130,000 shares of unrestricted stock to directors, officers and employees. The shares were issued in two equal installments shortly after June 30, 2013 and December 31, 2013. We expensed the entire $623,000 stock-based compensation expense related to this grant in the second, third and fourth quarters of 2013. We issued shares of common stock related to this grant as follows: i) 51,374 net shares of common stock were issued in early July 2013 after employees surrendered 13,626 shares for which we paid $71,000 of withholding taxes on their behalf; and ii) 49,936 net shares of common stock were issued in early January 2014 after employees surrendered 15,064 shares for which we paid $92,000 of withholding taxes on their behalf.

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F) Business Segments. We organize ourselves into a single segment that reports to the chief operating decision makers.

We conduct our operations in the United States and sell our products and services to domestic and international customers. Revenues were generated from the following geographic regions (in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
United States	$ 5,496	$ 3,510
Rest of world	1,121	1,468
	$ 6,617	$ 4,978

There were no single foreign countries from which we derived 10% or more of total revenue in the three month periods ended March 31, 2014 and 2013.

G) Recent Accounting Pronouncements. There are no recently issued accounting pronouncements applicable to the Company that have not been adopted as of March 31, 2014.

H) Income Taxes. Income tax expense was $0.5 million and $1.1 million for the three months ended March 31, 2014 and 2013, respectively. Income tax expense in both three month periods was based on the U.S. statutory rate of 34%, increased by state income taxes.

In the three months ended March 31, 2014 and 2013, we utilized deferred tax assets to reduce our tax liability payable to the government. A portion of the deferred tax assets we used comprised cumulative deductions for stock options in excess of book expense. Under income tax accounting rules, that portion of tax benefits attributable to such deductions must be recorded as an adjustment to equity versus a reduction of income tax expense. The tax benefits from such stock-based awards were $0.6 million and $0.8 million in the three month periods ended March 31, 2014 and 2013, respectively. These tax benefits were recorded as an equity adjustment to additional paid-in capital.

As of March 31, 2014, we had a total of $1.1 million of deferred tax assets for which we had recorded no valuation allowance. We will continue to assess the level of valuation allowance in future periods. Should evidence regarding the realizability of tax assets change at a future point in time, the valuation allowance will be adjusted accordingly.

In addition to deferred tax assets carried on our balance sheet, we also had net federal and state research and development credit carryforwards available at December 31, 2013 of $4.9 million and $0.7 million. These credits were not recorded as tax assets as they relate to excess stock compensation deductions that may not be recorded as tax assets under generally accepted accounting principles until the amounts have been utilized to reduce our tax liability. To the extent that these assets are used to reduce future taxes, the benefit will be recorded as a reduction to additional paid-in capital. The aforementioned $0.6 million and $0.8 million equity adjustment to additional paid-in capital in the first quarters of 2014 and 2013 were related to these deferred tax assets.

(I) Discontinued Operations. In 2013, we shut down our DSL service assurance software product line, which was previously a component of our DSL Service Assurance Segment. We completed the shutdown in the fourth quarter of 2013 and no longer have any continuing involvement with, or cash flows from, this product line. The results of our DSL service assurance software product line have been included in discontinued operations in the consolidated statements of income and comprehensive income. The loss from discontinued operations attributable to the DSL service assurance software product line was (in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Revenue	$ -	$ 638
Expenses	-	828
Loss before income taxes	-	(190)
Income taxes	-	75
Loss from discontinued operations	$ -	$ (115)

The consolidated statements of income and comprehensive income for the three months ended March 31, 2013 have been reclassified to reflect the effect of discontinued operations as set forth above.

There were no assets or liabilities remaining on the balance sheet as of March 31, 2014 related to the DSL Service Assurance Segment. The following table is a rollforward of our exit costs liability accounts for the three months ended March 31, 2014 (in thousands):

	Severance and Employee-Related Costs	Total
Balance at January 1, 2014	$ 90	$ 90
Amount charged to expense	-	-
Payments	(90)	(90)
Balance at March 31, 2014	$ -	$ -

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ITEM 2:
Management's Discussion and Analysis of
Financial Condition and Results of Operations

Cautionary Statement for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995

Some of the information in this Form 10-Q contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as "may," "will," "expect," "anticipate," "believe," "estimate," "continue" and similar words. You should read statements that contain these words carefully because they: (1) discuss our future expectations; (2) contain projections of our future operating results or financial condition; or (3) state other "forward-looking" information. However, we may not be able to predict future events accurately. The risk factors listed in our Annual Report on Form 10-K for the year ended December 31, 2013, as well as any cautionary language in this Form 10-Q, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should be aware that the occurrence of any of the events described in these risk factors and elsewhere in this Form 10-Q could materially and adversely affect our business.

Summary of Operations

Continuing Operations. We are primarily engaged in the development and sale of biometrics products and services. Our biometrics products are used in government and commercial biometrics systems, which are capable of determining or verifying an individual's identity. The principal applications of biometrics systems include border control, law enforcement, national defense, secure credentialing, access control and background checks. We sell our software and services to systems integrators and OEMs, as well as directly to government customers. We also derive a minor portion of our revenue from the sale of imaging software to OEMs that incorporate that software into medical imaging products.

Discontinued Operations. In 2013, we shut down our DSL service assurance software product line, which was previously a component of our DSL Service Assurance Segment. The results of the DSL Service Assurance Segment have been reported as discontinued operations as we no longer have any significant continuing involvement with, or cash flows from, this segment.

Summary of Financial Results

Net income from continuing operations for the three months ended March 31, 2014 was \$0.9 million, or \$0.04 per diluted share, which compares to net income from continuing operations of \$2.0 million, or \$0.09 per diluted share, for the three months ended March 31, 2013.

Lower net income from continuing operations in three month period ended March 31, 2014 compared to the corresponding period in 2013 was the result of:

i) \$0.9 million less operating income before patent related income in the current quarter. The decrease was primarily due to a large government software license sale in the year ago quarter that did not repeat itself in the current year quarter;
ii) the absence of any income from patent arrangement in the current year quarter compared to \$0.8 million of such income in the year ago quarter; and

iii) lower income before income taxes from these two sources was partially offset by a $0.6 million decrease in income tax expense.

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Results of Operations

Software Licenses. Software licenses consist of revenue from the sale of biometrics and imaging software products. Sales of software products depend on our ability to win proposals to supply software for biometrics systems projects either directly to government customers or indirectly through channel partners.

Software license revenue decreased 51% from $3.3 million in the three months ended March 31, 2013 to $1.6 million in the same three month period in 2014. As a percentage of total revenue, software license revenue decreased from 67% in the first quarter of 2013 to 24% in the current year quarter. The dollar decrease in software license revenue was primarily due to a comparison against a strong quarter last year. The first quarter of 2013 featured: i) a large license sale to a U.S. government agency; and ii) higher international license sales. The first quarter of 2014 did not contain any license sales of the magnitude of last year's U.S. government agency sale and international sales were lower than last year.

While we believe our potential customer project opportunities are encouraging, some of the projects that we thought would yield license revenue this quarter did not. We believe that we may experience an increase in license sales in future quarters as we win projects and release new products.

Software maintenance. Software maintenance consists of revenue from the sale of software maintenance contracts. Software maintenance contracts entitle customers to receive software support and software updates, if and when they become available, during the term of the contract.

Software maintenance revenue increased 10% from $947,000 in the three months ended March 31, 2013 to $1.0 million in the same three month period in 2014. As a percentage of total revenue, software maintenance revenue decreased from 19% in the first quarter of 2013 to 16% in the current year quarter. The dollar increase in software maintenance revenue was primarily due to a base of maintenance revenue from contract renewals from prior periods that grows as we sell maintenance contracts with new licenses in current periods.

Services. Services consist of fees we charge to perform software development, integration, installation, and customization services. Similar to software license revenue, services revenue depends on our ability to win biometrics systems projects either directly with government customers or in conjunction with channel partners. Services revenue will fluctuate when we commence new projects and/or when we complete projects that were started in previous periods.

Services increased 148% from $407,000 in the three months ended March 31, 2013 to $1.0 million in the same three month period in 2014. As a percentage of total revenue, services increased from 8% in the first quarter of 2013 to 15% in the current year quarter. The dollar increase in services was primarily due to a significant project with a U.S. government customer that commenced in the third quarter of 2013 and continued into the current quarter.

Hardware sales. Hardware sales consist of sales of biometrics equipment to a single U.S. government customer for whom we developed biometrics software. Hardware products sold to this customer integrate hardware purchased from third parties with software from other third parties as well as software from Aware. We evaluated the classification of gross versus net revenue recognition and determined gross recognition was appropriate.

Hardware sales increased from $0 in the three months ended March 31, 2013 to $2.6 million in the same three month period in 2014. As a percentage of total revenue, hardware sales increased from 0% in the first quarter of 2013 to 40% in the current year quarter. The dollar increase in hardware sales was due to the fact that we delivered products in the current quarter, but had not begun delivering products in the year ago quarter. We commenced shipments of equipment under this contract in May 2013.

We are unable to predict future hardware sales with any degree of certainty because: i) our contract with the government provides pricing, but does not obligate the government to purchase any products until it provides us with purchase orders; and ii) we have minimal historical experience with which to make revenue projections.

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Royalties. Royalties consist primarily of royalty payments we receive under DSL silicon contracts with two customers that incorporate our silicon intellectual property (“IP”) in their DSL chipsets. We sold our DSL IP business in 2009, but we continue to receive royalty payments from these customers.

Royalties increased 8% from $291,000 in the three months ended March 31, 2013 to $314,000 in the same three month period in 2014. As a percentage of total revenue, royalties decreased from 6% in the first quarter of 2013 to 5% in the current year quarter.

Although royalties increased slightly this quarter, we believe it is likely that royalties will decline in future quarters.

Cost of Hardware Sales. Cost of hardware sales consists primarily of the cost of third party equipment and software included in hardware shipments.

Cost of hardware sales increased from $0 in the three months ended March 31, 2013 to $1.9 million in the same three month period in 2014. Cost of hardware sales as a percentage of hardware sales were 72% in the first quarter of 2014, which means that gross margins on hardware sales were 28%. The dollar increase in cost of hardware sales was due to the occurrence of hardware shipments in the current quarter versus no shipments in the year ago quarter.

Cost of Services. Cost of services consists of engineering costs to perform customer services projects. Such costs primarily include: i) engineering salaries, stock-based compensation, fringe benefits, and facilities; and ii) engineering consultants and contractors.

Cost of services increased 135% from $197,000 in the three months ended March 31, 2013 to $463,000 in the same three month period in 2014. Cost of services as a percentage of services decreased from 48% in the first quarter of 2013 to 46% in the current quarter, which means that gross margins on services increased from 52% to 54%.

The 135% increase in cost of services in the first quarter of 2014 was mainly attributable to a 148% increase in services revenue.

Research and Development Expense. Research and development expense consists of costs for: i) engineering personnel, including salaries, stock-based compensation, fringe benefits, and facilities; ii) engineering consultants and contractors, and iii) other engineering expenses such as supplies, equipment depreciation, dues and memberships and travel. Engineering costs incurred to develop our technology and products are classified as research and development expense. As described in the cost of services section, engineering costs incurred to provide engineering services for customer projects are classified as cost of services, and are not included in research and development expense.

The classification of total engineering costs to research and development expense and cost of services was (in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Research and development expense	$ 1,279	$ 973
Cost of services	463	197
Total engineering costs	$ 1,742	$ 1,170

Research and development expense increased 31% from $1.0 million in the three months ended March 31, 2013 to $1.3 million in the same three month period in 2014. As a percentage of total revenue, research and development expense decreased slightly from 19.5% in the first quarter of 2013 to 19.3% in the corresponding period of 2014.

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As the table immediately above indicates, total engineering costs in the first quarter of 2014 increased by $572,000 compared to the same period last year. The spending increase was primarily due to the hiring of engineering employees and contractors commencing in the second half of 2013 and continuing into the first quarter of 2014. Our engineering headcount, not including contractors, grew from 31 as of March 31, 2013 to 43 as of March 31, 2014. The expansion of our engineering organization was designed to provide the resources we required: i) to pursue new product development initiatives; and ii) to staff customer engineering services projects.

As we described in the strategy section of our Form 10-K for the year ended December 31, 2013, we intend to introduce new products that will allow us to sell more software into biometrics systems and projects. Our preference is to develop such products internally, however to the extent we are unable to do that, we may purchase or license technologies from third parties. The engineering spending increase in the first quarter of 2014 is a reflection of that strategy. We anticipate that we will continue to focus our future research and development activities on enhancing our existing products and developing new products.

Selling and Marketing Expense. Selling and marketing expense primarily consists of costs for: i) sales and marketing personnel, including salaries, sales commissions, stock-based compensation, fringe benefits, travel, and facilities; and ii) advertising and promotion expenses.

Sales and marketing expense was essentially unchanged at $0.9 million for the three months ended March 31, 2013 and 2014. As a percentage of total revenue, sales and marketing expense decreased from 18% in the first quarter of 2013 to 13% in the corresponding period of 2014.

Unchanged sales and marketing expense in the first quarter of 2014 reflects two sets of offsetting factors. Sales and marketing expense increased due to the addition of one employee in 2014, but was offset by lower sales commission expense.

General and Administrative Expense. General and administrative expense consists primarily of costs for: i) officers, directors and administrative personnel, including salaries, bonuses, director compensation, stock-based compensation, fringe benefits, and facilities; ii) professional fees, including legal and audit fees; iii) public company expenses; and iv) other administrative expenses, such as insurance costs and bad debt provisions.

General and administrative expense increased 10% from $0.7 million in the three months ended March 31, 2013 to $0.8 million in the same three month period in 2014. As a percentage of total revenue, general and administrative expense decreased from 15% in the first quarter of 2013 to 12% in the current year quarter.

The $73,000 increase in general and administrative expense in the first quarter of 2014 was primarily due to higher patent filing expenses. Patent filing expenses in the first quarter of 2013 were reduced by a credit from our law firm related to 2012.

Stock-based compensation expense in general and administrative expense for the remaining three quarters of 2014 will increase over the first quarter of 2014 by approximately $215,000 per quarter. The increase is the result of an unrestricted stock award to directors and officers that the Compensation Committee authorized on March 26, 2014.

Income from Patent Arrangement. In December 2010, we entered into an arrangement with an unaffiliated third party under which we assigned certain patents in return for royalties on proceeds from patent monetization efforts by the third party. In the three months ended March 31, 2013, we received a royalty statement from this entity and recorded $0.8 million of income from this patent arrangement. There was no such income in the three months ended March 31,

2014. We are unable to predict how much more income we might receive from this arrangement, if any, because we do not know whether any patent monetization efforts by the third party will be successful.

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Interest Income. Interest income increased 5% from $82,000 in three months ended March 31, 2013 to $86,000 in the same three month period in 2014. The dollar increase was primarily due higher levels of cash and investments in the current year period.

Income Taxes. Income tax expense was $0.5 million and $1.1 million for the three months ended March 31, 2014 and 2013, respectively. Income tax expense in both three month periods was based on the U.S. statutory rate of 34%, increased by state income taxes.

In the three months ended March 31, 2014 and 2013, we utilized deferred tax assets to reduce our tax liability payable to the government. A portion of the deferred tax assets we used comprised cumulative deductions for stock options in excess of book expense. Under income tax accounting rules, that portion of tax benefits attributable to such deductions must be recorded as an adjustment to equity versus a reduction of income tax expense. The tax benefits from such stock-based awards were $0.6 million and $0.8 million in the three month periods ended March 31, 2014 and 2013, respectively. These tax benefits were recorded as an equity adjustment to additional paid-in capital.

As of March 31, 2014, we had a total of $1.1 million of deferred tax assets for which we had recorded no valuation allowance. We will continue to assess the level of valuation allowance in future periods. Should evidence regarding the realizability of tax assets change at a future point in time, the valuation allowance will be adjusted accordingly.

In addition to deferred tax assets carried on our balance sheet, we also had net federal and state research and development credit carryforwards available at December 31, 2013 of $4.9 million and $0.7 million. These credits were not recorded as tax assets as they relate to excess stock compensation deductions that may not be recorded as tax assets under generally accepted accounting principles until the amounts have been utilized to reduce our tax liability. To the extent that these assets are used to reduce future taxes, the benefit will be recorded as a reduction to additional paid-in capital. The aforementioned $0.6 million and $0.8 million equity adjustment to additional paid-in capital in the first quarters of 2014 and 2013 were related to these deferred tax assets.

Loss from discontinued operations. Loss from discontinued operations reflects operating results from our DSL service assurance software product line that we shutdown during 2013. The loss from such discontinued operations was (in thousands):

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Revenue	$ -	$ 638
Expenses	-	828
Loss before income taxes	-	(190)
Income taxes	-	75
Loss from discontinued operations	$ -	($ 115)

Liquidity and Capital Resources

At March 31, 2014, we had cash and cash equivalents of $74.4 million, which represented an increase of $1.7 million from December 31, 2013. The increase in cash was primarily due to $1.2 million of cash provided by operations and $0.5 million of cash provided by financing activities. Cash from these two sources was partially offset by $11,000 used to purchase capital equipment.

Cash provided by financing activities consisted of: i) $594,000 of excess tax benefits from stock-based compensation; and ii) $9,000 of proceeds from the exercise of stock options. Cash provided by these activities was partially offset by $92,000 of cash used to pay income taxes for employees who surrendered shares in connection with stock grants.

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Capital spending was primarily related to the purchase of computer hardware used principally in engineering activities.

While we cannot assure you that we will not require additional financing, or that such financing will be available to us, we believe that our cash and cash equivalents will be sufficient to fund our operations for at least the next twelve months.

Recent Accounting Pronouncements

See Note G to our Consolidated Financial Statements in Item 1.

ITEM 3:
Quantitative and Qualitative Disclosures about Market Risk

Our exposure to market risk relates primarily to our investment portfolio, and the effect that changes in interest rates would have on that portfolio. Our investment portfolio at March 31, 2014 consisted of two elements:

1. Cash and cash equivalents. As of March 31, 2014, our cash and cash equivalents of $74.4 million were primarily invested in money market funds. The money market funds were invested in high quality, short term financial instruments. Due to the nature, short duration, and professional management of these funds, we do not expect that a general increase in interest rates would result in any material loss.

2. Investments. As of March 31, 2014, our investments of $2.9 million were invested in high yield bonds with five corporate debt issuers, which mature in 2015 through 2018. While we are exposed to default risk, the high current yield of these bonds largely mitigates interest rate risk. Therefore, due to the high current yield and the two to five year life of these instruments, we do not believe that a general increase in interest rates would result in any material loss.

We do not use derivative financial instruments for speculative or trading purposes.

ITEM 4:
Controls and Procedures

Our management, including our co-chief executive officers and chief financial officer, has evaluated our disclosure controls and procedures as of the end of the quarterly period covered by this Form 10-Q and has concluded that our disclosure controls and procedures are effective. They also concluded that there were no changes in our internal control over financial reporting that occurred during the quarterly period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1:
Legal Proceedings

From time to time we are involved in litigation incidental to the conduct of our business. We are not party to any lawsuit or proceeding that, in our opinion, is likely to seriously harm our business.

ITEM 1A:
Risk Factors

The risks described in Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2013, could materially and adversely affect our business, financial condition and results of operations. The risk factors discussed in that Form 10-K do not identify all risks that we face because our business operations could also be affected by additional factors that are not presently known to us or that we currently consider to be immaterial to our operations. No material change in the risk factors discussed in that Form 10-K has occurred.

ITEM 4:
Mine Safety Disclosures

Not applicable.

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ITEM 6:

Exhibits

(a) Exhibits

Exhibit 31.1	Certification of co-Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification of co-Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
Exhibit 101*	The following financial statements from Aware, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language), as follows: (i) Consolidated Balance Sheets as of March 31, 2014 and December 31, 2013, (ii) Consolidated Statements of Income and Comprehensive Income for the Three Months Ended March 31, 2014 and March 31, 2013, (iii) Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2014 and March 31, 2013, and (iv) Notes to Consolidated Financial Statements.

* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto shall not be deemed filed for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under those sections.

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.

AWARE, INC.

Date: April 28, 2014

By: /s/ Kevin T. Russell
Kevin T. Russell
co-Chief Executive Officer &
co-President
General Counsel

Date: April 28, 2014

By: /s/ Richard P. Moberg
Richard P. Moberg
co-Chief Executive Officer &
co-President
Chief Financial Officer (Principal
Financial and Accounting Officer)

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