NIGHTHAWK SYSTEMS INC
Form 10KSB
April 18, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-KSB

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

COMMISSION FILE NO. 0-30786

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

NEVADA	**87-0627349**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

10715 GULFDALE, STE 200

SAN ANTONIO, TEXAS 78258

(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 Securities Exchange Act of 1934 during the preceding 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 [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and will not 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.

Registrant's revenues for its most recent fiscal year were $899,175

The aggregate market value of the voting and non-voting common stock held by non-affiliates based on the closing price on April 16, 2007 was $16,817,299

As of April 16, 2007 there were 96,098,850 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) 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.

Simply put, Nighthawk products allow customers to turn things on or off without manually flipping a switch. Our 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 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.

Nighthawk Systems 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 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.

NIGHTHAWK TECHNOLOGY

CORE TECHNOLOGY

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 in 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 product 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 a 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.

MARKETS AND PRODUCTS

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 M2M related products. There are more than 50 billion machines inhabiting the planet today (Wofgang 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. (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. (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. (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. 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 par−ticular 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 disconnec−tion, 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 calcu−late 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 technolo−gies that would allow for the remote connect/disconnect of energy meters. Additional findings from the report es−timate that approximately 2.3% of the United States electric meters were individually disconnected and reconnected on more than four occasions resulting in es−timated 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 de−ploying 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 condition−ing units in another area of the organiza−tion s power grid. The Nighthawk solution is also capable of acti−vating or de-activat−ing 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 has successfully filled an order for 5,000 load control devices for the Alabama Municipal Electric Association, which is in discussion with Nighthawk concerning a need for 10,000 additional devices.

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 then 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 then 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 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 acces−sibility 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. NIHK plans to grow this segment of its busi−ness over the next few years as demand for product continues to grow.

Because NIHK 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 com−pleted stages that will interface with existing emergency notifica−tion systems in order to optimally notify all necessary parties of a poten−tial 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:

- Firehouse Automation & Alerting

- Volunteer Alerting

- Public Emergency Notification

- EMS Automation & Alerting

- 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.

One 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 80 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 manage−ment, the user simply deploys another Nighthawk unit. In firehouse environments, where hearing and under−standing human verbal commands is extremely dif−ficult 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, emer−gency 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 informa−tion 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 person−nel 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. He 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 2005 and 2006, the Company expensed approximately $36,479 and $101,160 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.

PATENT PENDING

The Company has a patent application pending at the U.S. Patent Officetitled "Remote Disconnect Systems for Utility Meters" for whole house disconnect systems. Under the patent application, the user dials a pager number that is pre-programmed into the unit. The paging service then transmits a signal to a radio frequency ("RF") receiver in the module. The signal is then decoded and sent to a processor. The processor then causes a relay to open or close in accordance with the decoded signal in order to connect or disconnect the electrical power.

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 is in flux 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 24x7 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 2 way remote disconnect focusing on CDMA technology. The 2 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 afford 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 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 just 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 with current and future devices it has or will develop will provide the much sought after out-of-band solution.

SALES AND DISTRIBUTION

Nighthawk is positioned to take advantage of its growing customer base in the remote power control markets and has initiated a sales and marketing strategy that is proving to be successful. With a plan in place on how to continue to increase revenues, Nighthawk is efficiently and effectively utilizing its core staff to meet its objectives. The results of these efforts are apparent as revenue increases for 2006 reflect a 70% growth rate over 2005. Furthermore, this deliberate growth plan has generated positive results with respect to product mix and new customers from each of the targeted markets. This remarkable progress, together with the addition of a veteran executive from the utility industry, positions the Nighthawk team to continue with their growth strategy.

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

Sales Strategy -- Internal

After utilizing both inside and direct sales efforts, it was recently determined that the use of inside sales representatives is more effective in identifying and cultivating new customer relationships within the new target markets for Nighthawk. 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.

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:

Master Reselling Agent Large companies with enterprise accounts that Nighthawk will team with to sell bundled airtime and hardware product offerings utilizing the company s nationwide sales force. These agents share in the responsibility of developing and executing marketing activities such as trade shows, internet features, public relations, and advertising campaigns to feature Nighthawk products. Currently, Nighthawk is actively engaged with American Messaging, one of the largest paging carriers in the United States with 1.5 million commercial customers and 139 sales representatives. Nighthawk recently held product training sessions attended by 135

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American Messaging representatives, and has started to develop direct sales materials to be used in approaching American Messaging customers.

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 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.

Leverage new customer opportunities from current Agent/Reseller relationships.

American Messaging will co-market Nighthawk products to their customer base. They service many fortune 500 companies nationwide with wireless communications. American Messaging also provides wireless communications to many Federal, State, and Municipalities.

Utility agents such as Irby, Shealy, & Rumsey sell almost a billion dollars in annual revenues to utilities nation-wide. They pledge to co-promote Nighthawk products to their existing customer base.

Nighthawk has launched a new indirect sales & marketing training program designed to penetrate the agent/reseller current base of customers for maximum exposure in the B2B market place. Nighthawk will add many feet on the street through the agent/reseller indirect sales program at no cost to Nighthawk. American Messaging has over 100 B2B sales reps nation-wide. Through the use of new technology such as Webinars Nighthawk can jointly sell to new customers cultivated by it s indirect sales program without any travel expenses. This new technology will help Nighthawk touch many more customers than traditional face to face selling.

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 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.

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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 late in Q1 2007. 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, 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)

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. The Company leases the space at a monthly rate of $1,335. The Company's products are assembled and tuned in leased facilities located at 8200 East Pacific Place, Suite 204, Denver, Colorado. The lease for this facility expired on March 2002, but the Company has maintained use of the facilities on a month-to-month basis since that time. The leased property consists of approximately 2,400 square feet, for which the Company pays $1,650 per month. It consists of office space and a manufacturing floor.

ITEM 3. LEGAL PROCEEDINGS

Certain claims and lawsuits have arisen against the Company in its normal course of business. The Company believes that such claims and lawsuits have not had a material adverse effect on the Company's financial position, cash flow or results of operations. 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 in 2006. The Company held a special shareholders' meeting on January 6, 2005 to vote to approve an amendment to the Amended and Restated Articles of Incorporation of Nighthawk Systems, Inc. to increase the number of authorized shares of our common stock from 50,000,000 to 200,000,000. The results were as follows:

VOTES FOR	VOTES AGAINST	ABSTENTIONS
17,833,098	1,585,559	102,600

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(a) Market for Common Equity

Our common stock traded 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, 2007 and for each of the four quarters of the fiscal years ended December 31, 2006 and 2005:

QUARTER ENDED	HIGH	LOW	QUARTER ENDED	HIGH	LOW
March 31, 2007	$0.12	$0.06			
December 31, 2006	0.10	0.03	December 31, 2005	$0.09	$0.03
September 30, 2006	0.06	0.03	September 30, 2005	0.14	0.06
June 30, 2006	0.11	0.04	June 30, 2005	0.23	0.12
March 31, 2006	0.16	0.04	March 31, 2005	0.27	0.14

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 year-end 2006 was 185 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 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.

(d) Sales of Unregistered Securities

Between January 1, 2004 and March 31, 2004, we sold 858,333 shares of common stock to nine investors for cash at a price of $0.15 per share. Warrants to purchase 858,333 shares of common stock at an exercise price of $0.25 per share were also included in these sales. We did not publicly offer the securities and the investors were all accredited investors. No underwriters were involved in the sales.

Between May 31, 2004 and June 15, 2004, we sold 1,162,000 Special Warrants to five investors for cash at a price of $0.20 per Special Warrant. Each Special Warrant is convertible into one share of our common stock and one warrant to purchase a share of our common stock at an exercise price of $0.30 per share. First Associates Investments, Inc. was the underwriter in this offering. They received a commission of 8% of the total proceeds raised and the right to purchase 12.5% of the amount of the Special Warrants sold in the offering, or 142,250 Special Warrants.

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.

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 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. All purchases 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.

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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

Discussions and information in this document, which are not historical facts, should be considered forward-looking statements. With regard to forward-looking statements, including those regarding the potential revenues from increased sales, and the business prospects or any other aspect of Nighthawk Systems, Inc. ("the Company"), actual results and business performance may differ materially from that projected or estimated in such forward-looking statements. The Company has attempted to identify in this document certain of the factors that it currently believes may cause actual future experience and results to differ from its current expectations. Differences may be caused by a variety of factors, including but not limited to, adverse economic conditions, entry of new and stronger competitors, inadequate capital and the inability to obtain funding from third parties.

The following information should be read in conjunction with the Company's audited financial statements for the years ended December 31, 2006 and 2005.

OVERVIEW

The Company's financial results include the accounts of Nighthawk Systems, Inc. (formerly Peregrine, Inc.) and its subsidiary, Peregrine Control Technologies, Inc. ("PCT"). Effective February 1, 2002, the two companies were brought together under common management through an acquisition in which Peregrine, Inc. acquired all of the outstanding shares of PCT. Because Peregrine, Inc. issued more shares to acquire PCT than it had outstanding just prior to the acquisition, the transaction was accounted for as a reverse acquisition of Peregrine, Inc. by PCT. Peregrine, Inc. subsequently changed its name to Nighthawk Systems, Inc.

The Company designs and manufactures intelligent remote monitoring and power control products that are easy to use, inexpensive and can remotely control virtually any device from any location. Our proprietary, wireless products are ready to use upon purchase, so they are easily installed by anyone, regardless of technical ability, and are also easily integrated into third-party products, systems and processes. They allow for intelligent control by interpreting instructions sent via paging and satellite media, and executing the instructions by 'switching' the electrical current that

powers the device, system or process. Our intelligent products can be activated individually, in pre-defined groups, or en masse, and for specified time periods with a simple click of a mouse or by

dialing a telephone number.

Our products have been uniquely designed and programmed to be simple and ready to use upon purchase by anyone, almost anywhere, at affordable prices. As such, it is the Company's goal to have its products become commonplace, accepted and used by businesses and consumers alike in their daily routines.

We save consumers and businesses time, effort and expense by eliminating the need for a person to be present when and where an action needs to be taken. By utilizing existing wireless technology, we give our users the flexibility to move their application from place to place, without re-engineering their network. Currently, most commercial control applications utilize telephone lines, which tether the system to a single location and have associated installation and monthly charges. Our products make companies more profitable by eliminating installation costs and monthly charges for telephone lines, and allow for remote control of unmanned or remote locations that may operate on traditional electrical power, or solar or battery generated power.

Active applications for our intelligent products include, but are not limited to:

- Rebooting digital network components
- Remote switching of residential power
- Managing power on an electrical grid
- Activation/deactivation of alarm and warning devices
- Displaying or changing a digital or printed message or warning sign
- In-station firehouse alerting
- Turning irrigation systems on or off
- Turning heating or cooling equipment on or off

Companies both large and small are seeking ways to save money and lower the risk of liability by replacing processes that require human intervention with processes that can be controlled remotely without on-site human intervention. Today, the remote control of industrial or commercial assets and processes is performed mainly through the use of telephone-line or Internet-based systems. Opportunities exist for companies that provide intelligent wireless solutions, as telephone lines are expensive and limited in availability and function, and Internet-based solutions are not always available or desirable. Nighthawk's products are wireless, and can be designed to work with a variety of wireless media. They often offer an 'out of band' control solution - they function on a different network than the item to be turned on or off. The number of applications for wireless remote control is virtually limitless. The Company has identified primary markets (Utility, IT Professional, Traffic Control), as well as secondary markets (Irrigation, Outdoor Advertising, Oil/Gas, Security) for its products.

COMPARISON OF YEARS ENDED DECEMBER 31, 2006 AND 2005

REVENUE

The components of revenue and their associated percentages of total revenues, for the fiscal years ended December 31, 2006 and 2005 are as follows:

	YEARS ENDED DECEMBER 31,			
	2006		**2005**	
Product Revenues				
Utility	$ 348,895	39%	$ 157,470	30%
Logic Boards	274,590	31%	118,483	22%
Rebooting	156,655	17%	119,078	23%
Emergency Notification	56,459	6%	-	-
Irrigation	-	-	76,975	15%
Other product	15,406	2%	6,771	1%
Freight	6,834	1%	5,468	1%
Total product revenues	858,839	96%	484,245	92%
Airtime sales	40,336	4%	44,444	8%
Total revenues	$ 899,175	100%	$ 528,689	100%

Revenues for the year ended December 31, 2006 were $899,175 as compared to $528,689 for the prior year, an increase of 70% between periods. Sales of all of the Company's core products increased at least 32%% between the periods presented. During 2005, one customer, who purchased the Company's Hydro 1 product, represented approximately 15% of the Company's total revenue. This sale was made as part of a stated-funded project in New

Mexico, and the Company has not marketed or sold Hydro 1's since that time. The Company does not consider the Hydro 1 to be a core product that it markets and sells on an ongoing basis.

A sustained sales and marketing effort, which began in 2005 and was enhanced in 2006 with the hiring of new sales and marketing personnel, has allowed the company to stay in regular contact with and grow its customer base. Sales to both new and existing customers contributed significantly to revenues during fiscal 2006, with sales to new customers accounting for approximately 60% of total revenues for 2006. As a result, the company's dependence on a few large customers has continued to decrease annually since 2003. During 2006, one new customer accounted for 14% of total revenues, and one existing customer accounted for 11% of total revenues.

Airtime revenues decreased 9%, or $4,108 between the two periods presented. Recurring monthly airtime revenues from the Company's largest customer declined significantly in July 2005 when that customer lost its own remote monitoring contract with a customer, and airtime access to more than 2,400 rebooting units was canceled. However, the Company has continued to add new customers subsequent to June 2005, and as a result airtime revenues generated during the three month period ending December 31, 2006 exceeded airtime revenues generated during the same fiscal quarter of 2005 by approximately 82%.

Cost of goods sold includes parts and pre-manufactured components used to assemble our products as well as allocated overhead for production personnel and facilities costs. Cost of goods sold increased by $169,361 or 46% for 2006 from $369,331 for the prior year, but decreased as a percentage of revenues between the periods from 70% in 2005 to 60% in 2006. As a result, the Company's gross margin increased between the periods from 30% to 40%, and the Company produced $201,125 more gross margin in 2006 than it did in 2005. This improvement in gross margins is attributable to the increase in products produced during 2006 as compared to 2005, which led to volume discounts for parts and in-house production efficiencies, as well as to the mix of products sold. The increase in revenues assisted in covering fixed overhead charges at the Company's assembly facility in Denver, Colorado. The Company makes more margin dollars on the sale of its PT1000 logic boards than on any other product, and 31% of its revenues were produced by the sales of these boards in 2006 as compared to 22% in 2005.

Selling, general and administrative expenses for 2006 increased by $874,984 or 45% to $2,822,404 from $1,947,420 for 2005. During 2006, the Company recognized approximately $489,000 related to a note issued to Dutchess in exchange for consulting services performed during the year. This increase was also due to the recognition of approximately $736,000 in cash and noncash expenses incurred with public relations firms as compared to approximately $332,000 in similar expenses incurred in 2005. The Company also recognized $80,000 in non-cash expense associated with the vesting of options to purchase 4.0 million shares of stock which were granted to the Company's two board members, as well as approximately $91,000 in expenses incurred on a consultant hired on behalf of the Company by the two board members. The Company also incurred approximately $90,000 in fees for research and development efforts on new devices capable of bi-directional communication. These expenses were offset to some degree by decreases in legal fees incurred by the Company between the periods presented, as well as a decrease in expenses associated with payroll and contract employees between years.

Interest expense incurred on non-related party debt increased $308,275 or 34% between the years presented. The increase was due to interest expense related to the Dutchess notes and debentures, several which were paid off during the first quarter of 2006 prior to their maturity date. When this occurs, the Company expenses any unamortized discount associated with the debt being paid off, as well as any unamortized beneficial conversion expense, any unamortized expense associated with incentive shares issued with the debt, any early redemption penalties. During the first quarter of 2006, the Company recognized interest expense of approximately $153,000 related to the beneficial conversion feature of debentures, as well as approximately $192,000 in interest expense related for the value of incentive shares issued to Dutchess in exchange for money loaned to the Company. The Company also recognized approximately $77,000 in interest expense during the period in early redemption penalties on debentures that were paid off during the period. During the second through fourth quarters of 2006, monthly interest expense incurred actually declined, as most short term notes from Dutchess had either been paid off or had been rolled into long term debentures. These longer term arrangements allow the Company to expense loan discounts and incentive shares over longer periods of time, resulting in lower monthly interest accruals than shorter term notes.

LIQUIDITY AND CAPITAL RESOURCES

The Company s financial statements for 2006 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business.

The Report of our Independent Registered Public Accounting Firm on the Company's financial statements as of and for the year ended December 31, 2006 includes a "going concern" explanatory paragraph which means that the auditors expressed substantial doubt about the Company's ability to continue as a going concern. Although no assurance can be given that such plans will be successfully implemented, management's plans to address these concerns include:

- Raising working capital through additional borrowings.

- Raising equity funding through sales of the Company's common stock.

- Continued implementation of the Company s sales and marketing plans to generate additional cash flows from operations.

In August 2004, the Company signed a financing arrangement with Dutchess Private Equities, II, L.P. ("Dutchess") under which the Company received $250,000 in exchange for a convertible debenture during August 2004. The Company also signed an investment agreement under which Dutchess agreed to purchase up to $10.0 million in common stock from the Company, at the Company's discretion, over the next three years, subject to certain limitations including the Company's then current trading volume. Although the amount and timing of specific cash infusions available under the entire financing arrangement cannot be predicted with certainty, the arrangement represents a contractual commitment by Dutchess to provide funds to the Company. Since entering into the arrangement with Dutchess, the Company has utilized the arrangement to obtain enough cash to cover its operating cash flow deficits on a monthly basis.

During the year ended December 30, 2006, net cash used in operating activities was approximately $1.9 million. This net cash flow deficit was covered by proceeds of approximately $2.0 million from the issuance of a note and debentures to Dutchess during the period. Major cash outlays during the period were approximately $696,000 for payroll/employee benefits, $400,000 for public relations efforts, $402,000 for inventory, $172,000 for consulting expense, $126,000 for sales and marketing efforts, and $90,000 for product development. The amount of net cash used in operating activities of the Company decreased each successive quarter throughout 2006 as the Company's sales levels have increased at a faster rate than it has incurred expenses related to sales production. Net cash used from operations during the first, second, third and fourth fiscal quarters of 2006 was $605,116, $586,453, $372,384 and $345,710, respectively. Inan effort to reduce expenses, subsequent to September 30, 2006, Dutchess and the Company agreed to terminate their consulting arrangement and to discontinue the advanced funding of the Company through the issuance of notes. By doing so, the Company will no longer incur $10,000 in monthly consulting fees or fees and interest previously incurred with the issuance of new notes and debentures. Beginning in January 2007, the Company began accessing funds from Dutchess through the periodic issuances of puts under its existing investment agreement with Dutchess.

The Company issued 27,331,992 shares to Dutchess during 2006 which were used to pay down $1,742,767 in debt. Each note or debenture issued by the Company to Dutchess is secured by put notices, which allow Dutchess to exercise puts in order to pay down on the notes and debentures if they want to.

Until the Company is able to generate positive cash flows from operations in an amount sufficient to cover its current liabilities and debt obligations as they become due, it will remain reliant on borrowing funds from or selling equity to Dutchess or other parties to meet those obligations. Although the amount and timing of specific cash infusions available under the entire financing arrangement cannot be predicted with certainty, the arrangement represents a contractual commitment by Dutchess to provide funds to the Company.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Although our financial statements necessarily make use of certain accounting estimates by management, except as described below, we believe no matters that are the subject of such estimates are so highly uncertain or susceptible to change as to present a significant risk of a material impact on our financial condition or operating performance. Moreover, except as described below, the Company does not employ any critical accounting policies that are selected from among available alternatives or require the exercise of significant management judgment to apply.

REVENUE RECOGNITION

Revenue from product sales is recognized when all significant obligations of the Company have been satisfied. Revenues from equipment sales are recognized either on the completion of the manufacturing process, or upon shipment of the equipment to the customer, depending on the Company's contractual obligations. The Company is often prepaid for airtime services and is also occasionally prepaid for its products. These amounts are recorded as deferred revenue until the airtime services are provided or until the products have been manufactured.

STOCK-BASED COMPENSATION

During the first quarter of fiscal 2006, the Company adopted the provisions of, and accounts for stock-based compensation in accordance with, the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 123 - revised 2004 ("SFAS 123R") "Share-Based Payment" which replaced Statement of Financial Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees". Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. The Company elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding as of the

effective date and are subsequently modified.

We account for stock options granted to non-employees on a fair-value basis in accordance with SFAS 123R and EITF No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.

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