

Dear Fellow Investors,

The vision and hard work of the Wave Systems team over the past several years began to yield initial, tangible financial results during 2006. Wave's revenue increased 206% to a record \$3.1 million, primarily due to royalty contributions from bundling its software with PC OEM product shipments. Adjusting for the impact of non-cash, share-based compensation expenses, Wave held its 2006 net loss and cash burn in line with 2005 levels.

The PC industry has a history of driving new technology through standards and by shipping that technology to every user. These standardized technologies can create large markets to the benefit of companies in those industries. Ethernet, multimedia and USB are excellent examples of such market creation via standards. Although the adoption and utilization of new technology standards generally occurs over time, we believe that Trusted Computing has made significant progress as a new standard. Every major PC manufacturer now offers models with Trusted Platform Modules (TPMs) and many of them are shipping TPMs across multiple model lines and years.

Wave continues to make significant progress as the footprint of this industry standard expands and gains traction on a global basis. Evidence of this adoption can be seen in the continued growth of the Trusted Computing Group, the standards body behind the concept of Trusted Computing, which counts among its membership ranks over 140 companies, including many of the leading PC industry brands.

Industry analysts estimate that in excess of 50 million PCs bearing a TPM security chip were deployed globally throughout 2006. An additional 100 million TPM-enabled PCs are projected by these analysts to ship during 2007, with further acceleration in shipments anticipated for 2008 and beyond. Wave is committed to providing the client and server software to enable enterprises – and ultimately individuals – to harness the growing range of possible benefits to be derived from Trusted Computing.

Expanding Base of OEM Distribution

We were pleased to report that there have been significant recent developments in our relationship with Seagate Technology. Wave is pleased to be a launch partner with Seagate for its recently announced Full Disc Encryption (FDE) drive. We believe that this relationship could present significant opportunities. The Seagate drive represents a new approach to preventing the loss of data when a laptop is lost or stolen. By having the drive encrypt all of the data on the disk and administer access to that data, a very secure and very cost effective solution can be provided. We have leveraged our experience with hardware security, administration software, and PC standards and OEMs to emerge as a leading provider of the tools to support the Seagate FDE drives.

The FDE technology, when combined with a TPM and Wave's client and server ETS software, delivers a powerful security solution for mission-critical data and applications. Given the business risks and media attention regularly given to PC security breaches involving high-value enterprise data, we believe that FDE/Trusted Computing solutions are a timely offering to IT managers across a range of industries. Wave is working closely with Seagate and other OEM partners to help educate prospective customers on the benefits and relative ease of deployment of such solutions. It is too early to project the volumes this market may create, but we believe that the combined Wave/Seagate solution is very competitive. We also believe the FDE product line may serve as a catalyst for building awareness of, and driving adoption for, Trusted Computing solutions. A primary goal for Wave in 2007 is to focus our resources on supporting enterprises interested in evaluating and possibly deploying FDE solutions in conjunction with Trusted Computing.

The Enterprise Market

Since our last annual letter, we have worked to develop further interest in our software products amongst enterprises and government agencies, including branches of the government that have already specified TPMs as a required component for future PC purchases. Our sales, marketing and education effort is conducted both in conjunction with customers of our OEM partners as well as with prospects developed by Wave's own dedicated team.

Wave plays an important role in educating the market to the benefits of using TPMs and FDE drives to secure sensitive enterprise data. It continues to be a difficult process to convert interest into customers, but we have begun to see some tangible progress. We continue to work to broaden interest in the technology, and we are conducting a number of pilots and initial commercial deployments. We also see a growing commitment of resources and time, on the part of our enterprise and government prospects, being put into the evaluation of Trusted Computing solutions. This dynamic reaffirms our belief that the development of a meaningful commercial market for Trusted Computing solutions is underway. Wave continues to maintain a leading position in this emerging market.

Progress Outside of Trusted Computing

Outside of our Trusted Computing solutions, Wave has also worked to achieve progress with its eSign Transaction Management Suite, having established relationships with new partners in the mortgage/financial services industry over the past few months. eSign technology enables the signing, management and storage of electronic documents and is designed to be compatible with and enhanced by Wave's core applications in Trusted Computing. We view the management of the electronic document life cycle as an exciting area of opportunity for our Company.

We are also gratified by the progress of our subsidiary Wavexpress, including the integration of its TVTonic™ application with Windows Media Center in the Windows Vista Home Premium and Ultimate Editions. Similar to our core Trusted Computing solutions, we believe that Wavexpress' TVTonic application is ahead of its time but that the growing market for online video and rich media could present opportunities for this unique service.

Our Leadership Position Continues

As we review the landscape, we are pleased with the market position we have built over many years on strong engineering, industry expertise and active marketing. Our industry leadership is further supported by our compatibility strategy for TPM chips as well as our suite of server tools developed to help enterprises deploy and manage trusted computing solutions. Our server-based solutions, which are largely unique in the marketplace, include key management and backup, remote management of the TPM, Trusted Drive management, Platform Trust Services and Authentication servers. We believe these applications could take on essential roles as the rollout of Trusted Computing solutions progresses.

It has been a long and sometimes difficult road, but we do believe the momentum for Trusted Computing is growing and that Wave is well positioned to participate in that trend in 2007 and future years. We couldn't have gotten this far without the loyalty and hard work of our employees, or without the support of a substantial base of committed and patient shareholders. We thank you all for your contributions and support and look forward to reporting to you on our continued progress.

Sincerely,



Steven K. Sprague
President and Chief Executive Officer

April 16, 2007