SMITH MICRO SOFTWARE INC
Form 10-Q
August 03, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 01-35525

SMITH MICRO SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**33-0029027**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

51 COLUMBIA

ALISO VIEJO, CA 92656

(Address of principal executive offices, including zip code)

(949) 362-5800

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of July 27, 2012 there were 35,873,338 shares of common stock outstanding.

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SMITH MICRO SOFTWARE, INC.

QUARTERLY REPORT ON FORM 10-Q

June 30, 2012

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and par value data)

Assets	June 30, 2012 (unaudited)	December 31, 2011 (audited)
Current assets:		
Cash and cash equivalents	$ 10,966	$ 7,475
Short-term investments	20,289	38,497
Accounts receivable, net of allowances for doubtful accounts and other adjustments of $462 (2012) and $1,382 (2011)	8,385	8,525
Income tax receivable	7,687	8,293
Inventories, net of reserves for excess and obsolete inventory of $312 (2012) and $417 (2011)	236	309
Prepaid expenses and other current assets	1,554	1,138
Deferred tax asset	8	8
Total current assets	49,125	64,245
Equipment and improvements, net	13,181	15,482
Other assets	181	214
Total assets	$ 62,487	$ 79,941
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,720	$ 3,181
Accrued liabilities	6,392	7,641
Deferred revenue	1,172	703
Total current liabilities	9,284	11,525
Non-current liabilities:		
Long-term liabilities	3,363	3,546
Deferred tax liability	10	10
Total non-current liabilities	3,373	3,556
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value $0.001 per share; 5,000,000 shares authorized; none issued or outstanding		
Common stock, par value $0.001 per share; 100,000,000 shares authorized; 35,873,338 and 35,611,976 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	36	36
Additional paid-in capital	209,373	207,927
Accumulated comprehensive deficit	(159,579)	(143,103)
Total stockholders equity	49,830	64,860
Total liabilities and stockholders' equity	$ 62,487	$ 79,941

See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands, except per share data)

	Three Months Ended June 30, 2012 (unaudited)	Three Months Ended June 30, 2011 (unaudited)	Six Months Ended June 30, 2012 (unaudited)	Six Months Ended June 30, 2011 (unaudited)
Revenues	$ 10,171	$ 16,105	$ 20,285	$ 33,896
Cost of revenues	1,796	3,560	3,991	7,336
Gross profit	8,375	12,545	16,294	26,560
Operating expenses:				
Selling and marketing	3,954	7,097	8,546	15,459
Research and development	6,173	11,316	13,277	22,996
General and administrative	5,149	7,178	10,653	14,163
Restructuring expense (income)	(77)		257	
Total operating expenses	15,199	25,591	32,733	52,618
Operating loss	(6,824)	(13,046)	(16,439)	(26,058)
Interest and other income, net	31	42	54	85
Loss before provision for income taxes	(6,793)	(13,004)	(16,385)	(25,973)
Provision for income tax expense (benefit)	32	(5,157)	122	(10,373)
Net loss	(6,825)	(7,847)	(16,507)	(15,600)
Other comprehensive income (loss), before tax:				
Unrealized holding gains (losses) on available-for-sale securities	(3)	(8)	37	(1)
Income tax expense (benefit) related to items of other comprehensive income (expense)		(3)	6	
Other comprehensive income (expense), net of tax	(3)	(5)	31	(1)
Comprehensive loss	$ (6,828)	$ (7,852)	$ (16,476)	$ (15,601)
Net loss per share:				
Basic and diluted	$ (0.19)	$ (0.22)	$ (0.46)	$ (0.44)
Weighted average shares outstanding:				
Basic and diluted	36,045	35,775	35,818	35,520

See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(in thousands)

	Common stock Shares	Common stock Amount	Additional paid-in capital	Accumulated comprehensive deficit	Total
BALANCE, December 31, 2011	**35,612**	**$ 36**	**$ 207,927**	**$ (143,103)**	**$ 64,860**
Exercise of common stock options	14		11		11
Non cash compensation recognized on stock options and ESPP			30		30
Restricted stock grants, net of cancellations	589		2,124		2,124
Cancellation of shares for payment of withholding tax	(12)		(21)		(21)
Employee stock purchase plan (ESPP)	45		55		55
Shares repurchased and cancelled	(375)		(753)		(753)
Comprehensive loss				(16,476)	(16,476)
BALANCE, June 30, 2012 (unaudited)	**35,873**	**$ 36**	**$ 209,373**	**$ (159,579)**	**$ 49,830**

See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Six Months Ended June 30, 2012 (unaudited)	2011 (unaudited)
Operating activities:		
Net loss	$ (16,507)	$ (15,600)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,218	5,812
Loss on disposal of fixed assets	161	102
Lease incentives		2,223
Provision for doubtful accounts and other adjustments to accounts receivable	585	308
Provision for excess and obsolete inventory	33	63
Excess tax benefits from stock-based compensation		(157)
Non-cash compensation related to stock options and restricted stock	2,154	3,976
Change in operating accounts:		
Accounts receivable	(445)	17,433
Income tax receivable	606	(176)
Deferred taxes		(10,613)
Inventories	40	(19)
Prepaid expenses and other assets	(383)	(786)
Accounts payable and accrued liabilities	(2,445)	(2,316)
Net cash provided by (used in) operating activities	(13,983)	250
Investing activities:		
Capital expenditures	(78)	(11,332)
Sales of short-term investments	18,239	9,809
Net cash provided by (used in) investing activities	18,161	(1,523)
Financing activities:		
Excess tax benefits from stock-based compensation		157
Cash received from stock sale for employee stock purchase plan	55	345
Cash received from exercise of stock options	11	12
Repurchase of common stock	(753)	
Net cash provided by (used in) financing activities	(687)	514
Net increase (decrease) in cash and cash equivalents	3,491	(759)
Cash and cash equivalents, beginning of period	7,475	17,856
Cash and cash equivalents, end of period	$ 10,966	$ 17,097
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	$ 100	$ 262

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

Notes to the Consolidated Financial Statements

1. The Company

Smith Micro Software, Inc. (we, us, our, Smith Micro, or the Company) provides software and services that simplify, secure and enhance the mobile experience. The Company s portfolio of wireless solutions includes a wide range of client and server applications that manage voice, data, video and connectivity over mobile broadband networks. Our primary customers are the world s leading mobile network operators, mobile device manufacturers and enterprise businesses. In addition to our wireless and mobility software, Smith Micro offers personal productivity and graphics products distributed through a variety of consumer channels worldwide.

2. Basis of Presentation

The accompanying interim consolidated balance sheet and statement of stockholders equity as of June 30, 2012, and the related statements of comprehensive loss for the three and six months ended June 30, 2012 and the related cash flows for the six months ended June 30, 2012 and 2011 are unaudited. The unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted.

In the opinion of management, the accompanying unaudited consolidated financial statements for the periods presented reflect all adjustments, which are normal and recurring, necessary to fairly state the financial position, results of operations and cash flows. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC on February 27, 2012.

Intercompany balances and transactions have been eliminated in consolidation.

Operating results for the three and six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2012.

3. Net Income (Loss) Per Share

The Company calculates earnings per share (EPS) as required by Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic No. 260, Earning Per Share. Basic EPS is calculated by dividing the net income available to common stockholders by the weighted average number of common shares outstanding for the period, excluding common stock equivalents. Diluted EPS is computed by dividing the net income available to common stockholders by the weighted average number of common shares outstanding for the period plus the weighted average number of dilutive common stock equivalents outstanding for the period determined using the treasury-stock method. For periods with a net loss, the dilutive common stock equivalents are excluded from the diluted EPS calculation. For purposes of this calculation, common stock subject to repurchase by the Company and options are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

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	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(unaudited, in thousands, except per share amounts)			
Numerator:				
Net loss available to common stockholders	$ (6,825)	$ (7,847)	$ (16,507)	$ (15,600)
Denominator:				
Weighted average shares outstanding basic	36,045	35,775	35,818	35,520
Potential common shares options (treasury stock method)				
Weighted average shares outstanding diluted	36,045	35,775	35,818	35,520
Shares excluded (anti-dilutive)	18	209	25	348
Shares excluded due to an exercise price greater than weighted average stock price for the period	1,483	1,970	1,364	1,848
Net loss per common share:				
Basic	($ 0.19)	($ 0.22)	($ 0.46)	($ 0.44)
Diluted	($ 0.19)	($ 0.22)	($ 0.46)	($ 0.44)

4. Stock-Based Compensation

Stock Plans

During the six months ended June 30, 2012, the Company granted options to purchase 20,000 shares of common stock and 1.0 million shares of restricted stock, with a total value of $2.6 million. This cost will be amortized over a period of 12 to 48 months.

As of June 30, 2012 there were 3.0 million shares available for future grants under the 2005 Plan.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (ESPP), under which substantially all employees may purchase the Company s common stock through payroll deductions at a price equal to 85% of the lower of the fair market values of the stock as of the beginning and end of six-month offering periods. An employee s payroll deductions under the ESPP are limited to 10% of the employee s compensation and employees may not purchase more than the lesser of $25,000 of stock, or 1,000 shares, for any calendar year. Additionally, no more than 1,000,000 shares may be purchased under the plan. Shares purchased under the plan are valued using a Black-Scholes valuation model.

The Company s six-month offering period ended March 31, 2012 resulted in 44,666 shares being purchased/granted at a fair value of $0.69 per share. The next six-month offering period began on April 1, 2012 and will end on September 30, 2012. These shares will have a fair value of $0.93 per share.

Stock Compensation

The Company accounts for all stock-based payment awards made to employees and directors based on their fair values and recognized as compensation expense over the vesting period using the straight-line method over the requisite service period for each award as required by FASB ASC Topic No. 718, Compensation-Stock Compensation. Restricted stock is valued using the closing stock price on the date of the grant. Options are valued using a Black-Scholes valuation model.

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Stock-based non-cash compensation expenses related to stock options, restricted stock grants and the employee stock purchase plan were recorded in the financial statements as follows (in thousands):

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(unaudited)		(unaudited)	
Cost of revenues	$ 2	$ 5	$ 6	$ 22
Selling and marketing	222	511	439	1,095
Research and development	195	344	381	850
General and administrative	557	1,009	1,322	2,009
Restructuring expense			6	
Total non-cash stock compensation expense	$ 976	$ 1,869	$ 2,154	$ 3,976

Total share-based compensation for each quarter includes cash payment of income taxes related to grants of restricted stock in the amount of $0.1 million and $0.4 million in the three months ended June 30, 2012 and 2011, respectively. The cash payment of income taxes related to grants of restricted stock totaled $0.2 million and $1.3 million for the six months ended June 30, 2012 and 2011, respectively.

5. Fair Value of Financial Instruments

The Company measures and discloses fair value measurements as required by FASB ASC Topic No. 820, Fair Value Measurements and Disclosures.

The carrying value of accounts receivable, foreign cash accounts, prepaid expenses, other current assets, accounts payable, and accrued expenses are considered to be representative of their respective fair values because of the short-term nature of those instruments.

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the FASB establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

As required by FASB ASC Topic No. 820, we measure our cash equivalents and short-term investments at fair value. Our cash equivalents and short-term investments are classified within Level 1 by using quoted market prices utilizing market observable inputs.

As required by FASB ASC Topic No. 825, Financial Instruments, an entity can choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. Subsequent changes in fair value for designated items are required to be reported in earnings in the current period. This Topic also establishes presentation and disclosure requirements for similar types of assets and liabilities measured at fair value. As permitted, the Company has elected not to use the fair value option to measure our available-for-sale securities under this Topic and will continue to report as required by FASB ASC Topic No. 320, Investments-Debt and Equity Securities. We have made this election because the nature of our financial assets and liabilities are not of such complexity that they would benefit from a change in valuation to fair value.

6. Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash, government securities, mutual funds, and money market funds. These securities are primarily held in two financial institutions and are uninsured except for the minimum Federal Deposit Insurance Corporation (FDIC) coverage, and have original maturity dates of three months or less. As of June 30, 2012 and December 31, 2011, bank balances totaling approximately $5.7 million and $3.3 million, respectively, were uninsured.

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7. Short-Term Investments

Short-term investments consist of U.S. government agency and government sponsored enterprise obligations. The Company accounts for these short-term investments as required by FASB ASC Topic No. 320, Investments-Debt and Equity Securities. These debt and equity securities are not classified as either held-to-maturity securities or trading securities. As such, they are classified as available-for-sale securities. Available-for-sale securities are recorded at fair value, with unrealized gains or losses recorded as a separate component of accumulated other comprehensive income in stockholders equity until realized. Available-for-sale securities with contractual maturities of less than 12 months were as follows (in thousands):

		June 30, 2012			December 31, 2011	
	Fair value	Amortized cost basis	Net unrealized loss	Fair value	Amortized cost basis	Net unrealized loss
Corporate notes, bonds and paper	$ 13,532	$ 13,533	$ (1)	$ 31,180	$ 31,217	$ (33)
Government securities	6,757	6,760	(3)	7,317	7,321	(2)
Total	$ 20,289	$ 20,293	$ (4)	$ 38,497	$ 38,538	$ (35)

There was a de minimis amount of realized gains recognized for the three months and six months ended June 30, 2012.

8. Accounts Receivable

The Company performs ongoing credit evaluations of its customers and generally does not require collateral. The Company maintains reserves for estimated credit losses, and those losses have been within management s estimates. Allowances for product returns are included in other adjustments to accounts receivable on the accompanying consolidated balance sheets. Product returns are estimated based on historical experience and management estimations.

9. Inventories

Inventories consist principally of compact disks (CDs), boxes and manuals and are stated at the lower of cost (determined by the first-in, first-out method) or market. The Company regularly reviews its inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on management s forecast of product demand and production requirements. At June 30, 2012, our net inventory balance consisted of approximately $0.1 million of assembled products and $0.1 million of components.

10. Equipment and Improvements

Equipment and improvements are stated at cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the assets, generally ranging from three to seven years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful life of the asset or the lease term.

11. Segment, Customer Concentration and Geographical Information

Segment Information

Public companies are required to report financial and descriptive information about their reportable operating segments as required by FASB ASC Topic No. 280, Segment Reporting. The Company has two primary business units based on how management internally evaluates separate financial information, business activities and management responsibility. Wireless includes our connection management, mobile VPN, media and content management, device management, Push-To-Talk, Visual Voicemail, Voicemail to Text, video content delivery and network traffic optimization solutions. Productivity & Graphics includes retail and direct sales of our compression and broad consumer-based software. Corporate/Other revenue includes the consulting portion of our services sector which has been de-emphasized and is no longer considered a strategic element of our future plans.

The Company does not separately allocate operating expenses to these business units, nor does it allocate specific assets. Therefore, business unit information reported includes only revenues ..

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The following table shows the revenues generated by each business unit (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(unaudited)		(unaudited)	
Wireless	$ 8,731	$ 13,808	$ 17,306	$ 29,789
Productivity & Graphics	1,395	2,232	2,870	3,974
Corporate/Other	45	65	109	133
Total revenues	$ 10,171	$ 16,105	$ 20,285	$ 33,896

Customer Concentration Information

Revenues to two customers and their respective affiliates in the Wireless business segment accounted for 39.9% and 15.6% of the Company s total revenues for the three months ended June 30, 2012. Revenues to three customers and their respective affiliates in the Wireless business segment accounted for 33.8%, 18.4% and 11.4% of the Company s total revenues for the three months ended June 30, 2011. Revenues to two customers and their respective affiliates in the Wireless business segment accounted for 36.0% and 20.6% of the Company s total revenues for the six months ended June 30, 2012. Revenues to four customers and their respective affiliates in the Wireless business segment accounted for 23.1%, 19.2%, 12.1% and 11.3% of the Company s total revenues for the six months ended June 30, 2011.

Geographical Information

During the three and six months ended June 30, 2012 and 2011, the Company operated in three geographic locations; the Americas, Asia Pacific, and EMEA (Europe, the Middle East, and Africa). Revenues, attributed to the geographic location of the customer s bill-to address, were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(unaudited)		(unaudited)	
Americas	$ 8,308	$ 14,475	$ 16,992	$ 30,932
Asia Pacific	1,110	663	1,855	1,137
EMEA	753	967	1,438	1,827
Total Revenues	$ 10,171	$ 16,105	$ 20,285	$ 33,896

The Company does not separately allocate specific assets to these geographic locations.

12. Recent Accounting Pronouncements

In December 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-12, *Comprehensive Income (Topic 220).* The amendments in this Update supersede certain pending paragraphs in ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, to effectively defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. The amendments will be temporary to allow the Board time to redeliberate the presentation requirements for reclassifications out of accumulated other comprehensive income for annual and interim financial statements for public, private, and non-profit entities.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income.* Under the amendments to this Update, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company has implemented this guidance in this Form 10-Q.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurements and Disclosures (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The Company has implemented this guidance and its adoption has not had an impact on its consolidated results of operations and financial condition.

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13. Commitments and Contingencies

Leases

The Company leases its buildings under operating leases that expire on various dates through 2022. Future minimum annual lease payments under such leases as of June 30, 2012 are as follows (in thousands):

Year Ending December 31,	Operating
2012-6 months	$ 1,290
2013	2,612
2014	