

SMITH MICRO SOFTWARE INC  
Form 10-Q  
August 02, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**  
**FORM 10-Q**

**(Mark One)**

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended June 30, 2013**

**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**  
(State or other jurisdiction of  
incorporation or organization)

**33-0029027**  
(I.R.S. Employer  
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

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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 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  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  Non-accelerated filer  Small reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes  No

As of July 26, 2013 there were 37,043,264 shares of common stock outstanding.

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**SMITH MICRO SOFTWARE, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**June 30, 2013**  
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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****SMITH MICRO SOFTWARE, INC.****CONSOLIDATED BALANCE SHEETS****(in thousands, except share and par value data)**

| <b>Assets</b>   | June 30,<br>2013<br>(unaudited) | December 31,<br>2012<br>(audited) |
|---|---------------------------------|-----------------------------------|
| <b>Current assets:</b>  |                                 |                                   |
| Cash and cash equivalents   | \$ 9,161                        | \$ 18,873                         |
| Short-term investments  | 14,302                          | 13,328                            |
| Accounts receivable, net of allowances for doubtful accounts and other adjustments of \$384 (2013) and \$482 (2012) | 8,457                           | 8,953                             |
| Income tax receivable   | 679                             | 681                               |
| Inventories, net of reserves for excess and obsolete inventory of \$349 (2013) and \$352 (2012)                     | 130                             | 176                               |
| Prepaid expenses and other current assets   | 1,275                           | 903                               |
| Deferred tax asset  | 89                              | 89                                |
| <b>Total current assets</b>   | <b>34,093</b>                   | <b>43,003</b>                     |
| Equipment and improvements, net   | 9,232                           | 11,211                            |
| Other assets  | 184                             | 181                               |
| <b>Total assets</b>   | <b>\$ 43,509</b>                | <b>\$ 54,395</b>                  |
| <b>Liabilities and Stockholders Equity</b>  |                                 |                                   |
| <b>Current liabilities:</b>   |                                 |                                   |
| Accounts payable  | \$ 1,828                        | \$ 1,978                          |
| Accrued liabilities   | 6,517                           | 4,829                             |
| Deferred revenue  | 1,074                           | 1,436                             |
| <b>Total current liabilities</b>  | <b>9,419</b>                    | <b>8,243</b>                      |
| <b>Non-current liabilities:</b>   |                                 |                                   |
| Deferred rent and other long-term liabilities   | 2,839                           | 3,399                             |
| Deferred tax liability  | 91                              | 91                                |
| <b>Total non-current liabilities</b>  | <b>2,930</b>                    | <b>3,490</b>                      |
| <b>Commitments and contingencies</b>  |                                 |                                   |
| <b>Stockholders equity:</b>   |                                 |                                   |

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|  |           |           |
|--|-----------|-----------|
| 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; 37,043,264 and 35,873,418 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively | 37        | 36        |
| Additional paid-in capital   | 213,063   | 211,165   |
| Accumulated comprehensive deficit  | (181,940) | (168,539) |
| Total stockholders' equity   | 31,160    | 42,662    |
| Total liabilities and stockholders' equity   | \$ 43,509 | \$ 54,395 |

See accompanying notes to the consolidated financial statements.

Table of Contents**SMITH MICRO SOFTWARE, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****(in thousands, except per share data)**

|   | Three Months Ended<br>June 30, |             | Six Months Ended<br>June 30, |             |
|---|--------------------------------|-------------|------------------------------|-------------|
|   | 2013                           | 2012        | 2013                         | 2012        |
|   | (unaudited)                    | (unaudited) | (unaudited)                  | (unaudited) |
| Revenues  | \$ 10,484                      | \$ 10,171   | \$ 22,086                    | \$ 20,285   |
| Cost of revenues  | 2,401                          | 1,796       | 4,845                        | 3,991       |
| Gross profit  | 8,083                          | 8,375       | 17,241                       | 16,294      |
| Operating expenses:   |                                |             |                              |             |
| Selling and marketing   | 4,569                          | 3,954       | 8,950                        | 8,546       |
| Research and development  | 5,900                          | 6,173       | 11,836                       | 13,277      |
| General and administrative  | 4,862                          | 5,149       | 9,804                        | 10,653      |
| Restructuring expense (income)  | -                              | (77)        | -                            | 257         |
| Total operating expenses  | 15,331                         | 15,199      | 30,590                       | 32,733      |
| Operating loss  | (7,248)                        | (6,824)     | (13,349)                     | (16,439)    |
| Interest and other income, net  | 8                              | 31          | 20                           | 54          |
| Loss before provision for income taxes                                      | (7,240)                        | (6,793)     | (13,329)                     | (16,385)    |
| Provision for income tax expense  | 4                              | 32          | 73                           | 122         |
| Net loss  | (7,244)                        | (6,825)     | (13,402)                     | (16,507)    |
| Other comprehensive income (loss), before tax:                              |                                |             |                              |             |
| Unrealized holding gains (losses) on available-for-sale securities          | (17)                           | (3)         | 1                            | 37          |
| Income tax expense related to items of other comprehensive income (expense) | -                              | -           | -                            | 6           |
| Other comprehensive income (expense), net of tax                            | (17)                           | (3)         | 1                            | 31          |
| Comprehensive loss  | \$ (7,261)                     | \$ (6,828)  | \$ (13,401)                  | \$ (16,476) |
| Net loss per share:   |                                |             |                              |             |
| Basic and diluted   | \$ (0.19)                      | \$ (0.19)   | \$ (0.36)                    | \$ (0.46)   |
| Weighted average shares outstanding:  |                                |             |                              |             |
| Basic and diluted   | 37,247                         | 36,045      | 36,932                       | 35,818      |

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  |              | Additional<br>paid-in<br>capital | Accumulated<br>comprehensive<br>deficit | Total            |
|---|---------------|--------------|----------------------------------|---|------------------|
|   | Shares        | Amount       |                                  |   |                  |
| <b>BALANCE, December 31, 2012</b>                             | <b>35,873</b> | <b>\$ 36</b> | <b>\$ 211,165</b>                | <b>\$ (168,539)</b>                     | <b>\$ 42,662</b> |
| Non cash compensation recognized on stock<br>options and ESPP | -             | -            | 80                               | -                                       | 80               |
| Restricted stock grants, net of cancellations                 | 1,186         | 1            | 1,845                            | -                                       | 1,846            |
| Cancellation of shares for payment of<br>withholding tax      | (35)          | -            | (48)                             | -                                       | (48)             |
| Employee stock purchase plan (ESPP)                           | 19            | -            | 21                               | -                                       | 21               |
| Comprehensive loss  | -             | -            | -                                | (13,401)                                | (13,401)         |
| <b>BALANCE, June 30, 2013 (unaudited)</b>                     | <b>37,043</b> | <b>\$ 37</b> | <b>\$ 213,063</b>                | <b>\$ (181,940)</b>                     | <b>\$ 31,160</b> |

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, |             |
|--|---------------------------|-------------|
|  | 2013                      | 2012        |
|  | (unaudited)               | (unaudited) |
| <b>Operating activities:</b>   |                           |             |
| Net loss   | \$ (13,402)               | \$ (16,507) |
| Adjustments to reconcile net loss to net cash used in operating activities:  |                           |             |
| Depreciation and amortization  | 2,119                     | 2,218       |
| Loss on disposal of fixed assets   | -                         | 161         |
| Provision for doubtful accounts and other adjustments to accounts receivable | 366                       | 585         |
| Provision for excess and obsolete inventory                                  | 54                        | 33          |
| Non-cash compensation related to stock options, ESPP and restricted stock    | 1,926                     | 2,154       |
| Change in operating accounts:  |                           |             |
| Accounts receivable  | 130                       | (445)       |
| Income tax receivable  | 2                         | 606         |
| Inventories  | (8)                       | 40          |
| Prepaid expenses and other assets  | (375)                     | (383)       |
| Accounts payable and accrued liabilities                                     | 568                       | (2,445)     |
| Net cash used in operating activities  | (8,620)                   | (13,983)    |
| <b>Investing activities:</b>   |                           |             |
| Capital expenditures   | (140)                     | (78)        |
| Sales (purchases) of short-term investments                                  | (973)                     | 18,239      |
| Net cash provided by (used in) investing activities                          | (1,113)                   | 18,161      |
| <b>Financing activities:</b>   |                           |             |
| Cash received from stock sale for employee stock purchase plan               | 21                        | 55          |
| Cash received from exercise of stock options                                 | -                         | 11          |
| Repurchase of common stock   | -                         | (753)       |
| Net cash provided by (used in) financing activities                          | 21                        | (687)       |
| Net increase (decrease) in cash and cash equivalents                         | (9,712)                   | 3,491       |
| Cash and cash equivalents, beginning of period                               | 18,873                    | 7,475       |
| Cash and cash equivalents, end of period                                     | \$ 9,161                  | \$ 10,966   |

Supplemental disclosures of cash flow information:

|                            |    |    |    |     |
|----------------------------|----|----|----|-----|
| Cash paid for income taxes | \$ | 77 | \$ | 100 |
|----------------------------|----|----|----|-----|

See accompanying notes to the consolidated financial statements.

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**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, 2013, and the related statements of comprehensive loss for the three and six months ended June 30, 2013 and 2012 and the related statements of cash flows for the six months ended June 30, 2013 and 2012 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, 2012 filed with the SEC on February 20, 2013.

Intercompany balances and transactions have been eliminated in consolidation.

Operating results for the three and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2013.

**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, Earnings 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.

|   | <b>Three Months Ended June 30,</b>                         |             | <b>Six Months Ended June 30,</b> |             |
|---|--|-------------|----------------------------------|-------------|
|   | <b>2013</b>  | <b>2012</b> | <b>2013</b>                      | <b>2012</b> |
|   | <b>(unaudited, in thousands, except per share amounts)</b> |             |                                  |             |
| <b>Numerator:</b>   |  |             |                                  |             |
| Net loss available to common stockholders   | \$ (7,244)   | \$ (6,825)  | \$ (13,402)                      | \$ (16,507) |
| <b>Denominator:</b>   |  |             |                                  |             |
| Weighted average shares outstanding - basic   | 37,247   | 36,045      | 36,932                           | 35,818      |
| Potential common shares - options (treasury stock method)   | -  | -           | -                                | -           |
| Weighted average shares outstanding - diluted   | 37,247   | 36,045      | 36,932                           | 35,818      |
| Shares excluded (anti-dilutive)   | -  | 18          | 8                                | 25          |
| Shares excluded due to an exercise price greater than weighted average stock price for the period | 2,323  | 1,483       | 1,457                            | 1,364       |
| <b>Net loss per common share:</b>   |  |             |                                  |             |
| Basic   | (\$ 0.19)  | (\$ 0.19)   | (\$ 0.36)                        | (\$ 0.46)   |
| Diluted   | (\$ 0.19)  | (\$ 0.19)   | (\$ 0.36)                        | (\$ 0.46)   |

**Table of Contents****4. Stock-Based Compensation***Stock Plans*

During the six months ended June 30, 2013, the Company granted options to purchase 100,000 shares of common stock and 1.5 million shares of restricted stock, with a total value of \$2.6 million. This cost will be amortized ratably over a period of 12 to 48 months.

As of June 30, 2013 there were 1.8 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 most recent six-month offering period ended March 31, 2013 and resulted in 18,594 shares being purchased/granted at a fair value of \$0.65 per share. The next six-month offering period began on April 1, 2013 and will end on September 30, 2013. These shares will have a fair value of \$0.44 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.

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):

|   | <b>Three Months Ended June 30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|---|------------------------------------|-------------|----------------------------------|-------------|
|   | <b>2013</b>                        | <b>2012</b> | <b>2013</b>                      | <b>2012</b> |
|   | <b>(unaudited)</b>                 |             | <b>(unaudited)</b>               |             |
| Cost of revenues                          | \$ 6                               | \$ 2        | \$ 11                            | \$ 6        |
| Selling and marketing                     | 334                                | 222         | 560                              | 439         |
| Research and development                  | 208                                | 195         | 417                              | 381         |
| General and administrative                | 473                                | 557         | 938                              | 1,322       |
| Restructuring expense                     | -                                  | -           | -                                | 6           |
| Total non-cash stock compensation expense | \$ 1,021                           | \$ 976      | \$ 1,926                         | \$ 2,154    |

Total share-based compensation for each quarter included cash payments of income taxes related to grants of restricted stock in the amount of \$0.1 million for both three month periods ended June 30, 2013 and 2012. The cash payments of income taxes related to grants of restricted stock totaled \$0.2 million for both six month periods ended June 30, 2013 and 2012.

## **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.

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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, 2013 and December 31, 2012, bank balances totaling approximately \$8.9 million and \$9.1 million, respectively, were uninsured.

## **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, 2013              |                                |                  | December 31, 2012          |                                |                  |
|---------------------------------------|----------------------------|--------------------------------|------------------|----------------------------|--------------------------------|------------------|
|                                       | Amortized<br>cost<br>basis | Gross unrealized<br>gain(loss) | Fair value       | Amortized<br>cost<br>basis | Gross unrealized<br>gain(loss) | Fair value       |
| Corporate notes, bonds and paper      | \$ 7,149                   | \$ -                           | \$ 7,149         | \$ 9,091                   | \$ (7)                         | \$ 9,084         |
| Government securities/money<br>market | 7,160                      | (7)                            | 7,153            | 4,245                      | (1)                            | 4,244            |
| <b>Total</b>                          | <b>\$ 14,309</b>           | <b>\$ (7)</b>                  | <b>\$ 14,302</b> | <b>\$ 13,336</b>           | <b>\$ (8)</b>                  | <b>\$ 13,328</b> |

Realized gains were zero for the three and six months ended June 30, 2013 and de minimis for the three 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.



**Table of Contents****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, 2013, our net inventory balance consisted of approximately \$0.1 million of primarily 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 QuickLink®, NetWise and CommSuit® family of products. Productivity & Graphics includes our consumer-based products: Poser®, Anime Studio®, Manga Studio, MotionArtist and StuffIt®.

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.

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

|                         | <b>Three Months Ended June 30,</b> |                  | <b>Six Months Ended June 30,</b> |                  |
|-------------------------|------------------------------------|------------------|----------------------------------|------------------|
|                         | <b>2013</b>                        | <b>2012</b>      | <b>2013</b>                      | <b>2012</b>      |
|                         | <b>(unaudited)</b>                 |                  | <b>(unaudited)</b>               |                  |
| Wireless                | \$ 8,525                           | \$ 8,776         | \$ 18,746                        | \$ 17,415        |
| Productivity & Graphics | 1,959                              | 1,395            | 3,340                            | 2,870            |
| <b>Total revenues</b>   | <b>\$ 10,484</b>                   | <b>\$ 10,171</b> | <b>\$ 22,086</b>                 | <b>\$ 20,285</b> |

*Customer Concentration Information*

A summary of the Company's customers that represent 10% or more of the Company's net revenues is as follows:

|  | <b>Three Months Ended June 30,</b> |             | <b>Six Months Ended June 30,</b> |             |
|--|------------------------------------|-------------|----------------------------------|-------------|
|  | <b>2013</b>                        | <b>2012</b> | <b>2013</b>                      | <b>2012</b> |

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Wireless:

|                                 |       |       |       |       |
|---------------------------------|-------|-------|-------|-------|
| Sprint (& affiliates)           | 51.2% | 39.9% | 53.3% | 36.0% |
| Verizon Wireless (& affiliates) | 18.4% | 15.6% | 16.9% | 20.6% |

Productivity & Graphics:

|            |       |     |       |     |
|------------|-------|-----|-------|-----|
| FastSpring | 15.1% | N/A | 11.2% | N/A |
|------------|-------|-----|-------|-----|

As of June 30, 2013 these three customers listed above comprised 91% of our accounts receivable. As of June 30, 2012 the two customers listed above comprised 69% of our accounts receivable.

**Table of Contents***Geographical Information*

During the three and six months ended June 30, 2013 and 2012, the Company operated in three geographic locations; the Americas, EMEA (Europe, the Middle East, and Africa) and Asia Pacific. Revenues, attributed to the geographic location of the customer's bill-to address, were as follows (in thousands):

|                | Three Months Ended June 30, 2013 |           | Six Months Ended June 30, 2012 |           |
|----------------|----------------------------------|-----------|--------------------------------|-----------|
|                | (unaudited)                      |           | (unaudited)                    |           |
| Americas       | \$ 10,223                        | \$ 8,308  | \$ 21,022                      | \$ 16,992 |
| EMEA           | 121                              | 753       | 622                            | 1,438     |
| Asia Pacific   | 140                              | 1,110     | 442                            | 1,855     |
| Total Revenues | \$ 10,484                        | \$ 10,171 | \$ 22,086                      | \$ 20,285 |

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

**12. Recent Accounting Pronouncements**

In February 2013, the FASB issued Accounting Standards Update ( ASU ) No. 2013-02, *Other Comprehensive Income (Topic 220)*. The amendments in this Update supersede and replace the presentation requirements for reclassifications out of accumulated other comprehensive income in ASUs 2011-05 (issued in June 2011) and 2011-12 (issued in December 2011) for all public and private organizations. The amendments require an entity to provide additional information about reclassifications out of accumulated other comprehensive income. The Company has implemented this guidance.

**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, 2013 are as follows (in thousands):

| Year Ending December 31, | Operating |
|--------------------------|-----------|
| 2013-6 months            | \$ 1,309  |
| 2014                     | 2,603     |
| 2015                     | 2,422     |
| 2016                     | 2,126     |
| 2017                     | 1,787     |
| 2018                     | 1,726     |
| Beyond                   | 4,588     |
| Total                    | \$ 16,561 |

Rent expense under operating leases was \$0.6 million for both three month periods ended June 30, 2013 and 2012. Rent expense under operating leases was \$1.2 million and \$1.4 million for the six months ended June 30, 2013 and 2012, respectively.

As a condition of our Pittsburgh lease that was signed in November 2010, the landlord agreed to incentives of \$40.00 per square foot, or a total of \$2.2 million, for improvements to the space. These costs have been included in deferred rent in our long-term liabilities and are being amortized over the ten year lease term.

*Pennsylvania Opportunity Grant Program*

On September 26, 2011, we received \$1.0 million from the State of Pennsylvania to help fund our agreement to start-up a new facility. The grant carries with it an obligation, or commitment, to employ at least 232 people within a three-year time period that ends on December 31, 2013. This grant contains conditions that would require us to return a pro-rata amount of the monies received if we fail to meet these conditions. As such, the monies have been recorded as a liability in the accrued liabilities line item on the balance sheet until we are irrevocably entitled to retain the monies.

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### *Litigation*

The Company is and may become involved in various legal proceedings arising from its business activities. While management does not believe the ultimate disposition of these matters will have a material adverse impact on the Company's consolidated results of operations, cash flows or financial position, litigation is inherently unpredictable, and depending on the nature and timing of these proceedings, an unfavorable resolution could materially affect the Company's future consolidated results of operations, cash flows or financial position in a particular period.

### *Other Contingent Contractual Obligations*

During our normal course of business, we have made certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These include: intellectual property indemnities to our customers and licensees in connection with the use, sale and/or license of our products; indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease; indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct; indemnities involving the accuracy of representations and warranties in certain contracts; and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware. We may also issue a guarantee in the form of a standby letter of credit as security for contingent liabilities under certain customer contracts. The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees may not provide for any limitation of the maximum potential for future payments we could be obligated to make. We have not recorded any liability for these indemnities, commitments and guarantees in the accompanying consolidated balance sheets.

## **14. Income Taxes**

We account for income taxes as required by FASB ASC Topic No. 740, Income Taxes. This Topic clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Topic also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Topic requires an entity to recognize the financial statement impact of a tax position when it is more likely than not that the position will be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. In addition, the Topic permits an entity to recognize interest and penalties related to tax uncertainties either as income tax expense or operating expenses. The Company has chosen to recognize interest and penalties related to tax uncertainties as operating expense.

The Company assesses whether a valuation allowance should be recorded against its deferred tax assets based on the consideration of all available evidence, using a more likely than not realization standard. The four sources of taxable income that must be considered in determining whether deferred tax assets will be realized are: (1) future reversals of existing taxable temporary differences (i.e., offset of gross deferred tax assets against gross deferred tax liabilities); (2) taxable income in prior carryback years, if carryback is permitted under the applicable tax law; (3) tax planning strategies and (4) future taxable income exclusive of reversing temporary differences and carryforwards.

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. A significant factor in the Company's assessment is that the Company was in a four-year historical cumulative loss as of the end of December 31, 2012. This fact, combined with uncertain near-term market and economic conditions, reduced the Company's ability to rely on projections of future taxable income in assessing the realizability of its deferred tax assets.

After a review of the four sources of taxable income as of December 31, 2012 (as described above), and after consideration of the Company's four-year cumulative loss position as of December 31, 2012, the Company has recorded valuation allowances related to its U.S.-based deferred tax amounts, with a corresponding charge to income tax expense, of \$60.5 million as of December 31, 2012.

In April 2013, the Internal Revenue Service began its examination of the Company's U.S. Federal tax return for the years ended December 31, 2009, 2010 and 2011.

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We may from time to time be assessed interest or penalties by major tax jurisdictions, although any such assessments historically have been minimal and immaterial to our financial results. It is the Company's policy to classify any interest and/or penalties in the financial statements as a component of general and administrative expense.

**15. Restructuring Expenses**

On July 25, 2013, the Board of Directors approved a plan of restructuring intended to bring the Company's operating expenses better in line with revenues. The restructuring plan involves a realignment of organizational structures, facility consolidations/closures and headcount reductions that will amount to approximately 25-30% of the Company's worldwide workforce. The restructuring plan is expected to be implemented primarily during the third quarter of the Company's 2013 fiscal year.

The Company currently expects that implementation of the restructuring plan will result in special charges totaling approximately \$5.0-6.8 million which will be recorded during the third quarter of 2013. These charges include lease/rental terminations of approximately 3.5 million, severance costs for affected employees of approximately \$0.9-1.5 million, and other related costs of approximately \$0.6-1.8 million all of which are cash expenditures. It is estimated that approximately \$2.7-3.1 million of cash expenditures will be paid out in 2013, and the remaining cash expenditures will be paid in future years.

The amounts stated above are preliminary and subject to change as we finalize our assessment of the charges and costs associated with the above items. These charges and cash expenditures do not take into consideration any potential cost savings associated with the plan of restructuring.

In February 2012, we undertook a restructuring that included a 7-8% reduction of headcount and other cost reductions that resulted in annualized savings of approximately \$7.0M. One-time employee termination and other costs resulted in restructuring expenses of \$0.3 million recorded in the period ended March 31, 2012. For the three month period ended June 30, 2012, we returned to profit \$0.1 million of the restructuring reserve as a result of lower one-time employee termination benefits and relocation expenses.

The following is the activity in our restructuring liability account which is included in the accrued liabilities line item on the balance sheet for the period ended June 30, 2013 (in thousands):

|  | December 31, 2012 |               |        |         | June 30, 2013 |
|--|-------------------|---------------|--------|---------|---------------|
|  | Balance           | Provision-net | Usage  | Reclass | Balance       |
| One-time employee termination benefits | \$ 8              | \$ -          | \$ -   | \$ (4)  | \$ 4          |
| Lease/rental terminations              | -                 | -             | -      | -       | -             |
| Relocation, move, other expenses       | -                 | -             | (4)    | 4       | -             |
| Total                                  | \$ 8              | \$ -          | \$ (4) | \$ -    | \$ 4          |

The remaining balance in the restructuring reserve is estimated to be used by the end of the fiscal year ending December 31, 2013.

**16. Stock Repurchase Program**

In November 2011, the Company announced that its Board of Directors had approved a program authorizing the repurchase of up to five million shares of the Company's common stock over a period of up to two years. Under this program, stock repurchases may be made from time to time and the actual amount expended will depend on a variety of factors including market conditions, regulatory and legal requirements, corporate cash generation and other factors. The stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of Rule 10b5-1 trading plans. The program does not obligate Smith Micro to repurchase any particular amount of common stock during any period and the program may be modified or suspended at any time at the Company's discretion. The Company did not repurchase any shares during the six month period ended June 30, 2013. During the six month period ended June 30, 2012, we repurchased 375,000 shares at a cost of \$0.8 million.

### **17. Subsequent Events**

The Company evaluates and discloses subsequent events as required by ASC Topic No. 855, Subsequent Events. The Topic establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. Subsequent events have been evaluated as of the date of this filing and no further disclosures were required.



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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*In this document, the terms Smith Micro, Company, we, us, and our refer to Smith Micro Software, Inc. and, where appropriate, its subsidiaries.*

*This report contains forward-looking statements regarding Smith Micro which include, but are not limited to, statements concerning projected revenues, expenses, gross profit and income, the competitive factors affecting our business, market acceptance of products, customer concentration, the success and timing of new product introductions and the protection of our intellectual property. These forward-looking statements are based on our current expectations, estimates and projections about our industry, management's beliefs, and certain assumptions made by us. Words such as anticipates, expects, intends, plans, predicts, potential, believes, seeks, estimates, should, may, will and variations of these words or similar expressions are intended to identify forward-looking statements. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed or implied in any forward-looking statements as a result of various factors. Such factors include, but are not limited to, the following:*

*changes in demand for our products from our customers and their end-users;*  
*our ability to predict consumer needs, introduce new products, gain broad market acceptance for such products and ramp up manufacturing in a timely manner;*  
*our business and stock price may decline further which could cause an additional impairment of long-lived assets or restructuring charge resulting in a material adverse effect on our financial condition and results of operations;*  
*the intensity of the competition and our ability to successfully compete;*  
*the pace at which the market for new products develop;*  
*the response of competitors, many of whom are bigger and better financed than us;*  
*our ability to protect our intellectual property and our ability to not infringe on the rights of others;*  
*the availability of third party intellectual property and licenses which may not be on commercially reasonable terms, or not at all;*  
*our ability to successfully execute our business and restructuring plan and control costs and expenses;*  
*the ongoing uncertainty and volatility in U.S. and worldwide economic conditions may adversely affect our operating results;*  
*security and privacy breaches in our systems may damage client relations and inhibit our ability to grow;*  
*interruptions or delays in the services we provide from our data center hosting facilities could harm our business; and*  
*those additional factors which are listed under the Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2012 and in this 10-Q on Page 21.*

*The forward-looking statements contained in this report are made on the basis of the views and assumptions of management regarding future events and business performance as of the date this report is filed with the Securities and Exchange Commission (the SEC). We do not undertake any obligation to update these statements to reflect events or circumstances occurring after the date this report is filed.*

**Overview**

Smith Micro Software, Inc. 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.

The proliferation of mobile broadband technology continues to provide new opportunities for Smith Micro on a global basis. Over the last decade, the Company has developed extensive expertise in embedded software for networked devices (both wireless and wired), and we have leveraged that expertise to solve an unending tide of connectivity and mobile service challenges for our customers. As network operators and businesses struggle to reduce costs and complexity in a market that is characterized by rapid evolution and fragmentation, Smith Micro answers with innovative solutions that increase reliability, security, performance, efficiency, and usability of wireless services over a wide variety of networks and device platforms.

Our innovative line of productivity and graphics products are distributed through a variety of consumer channels worldwide, our online stores, and third-party wholesalers, retailers and value-added resellers. We offer products that operate on Windows, Mac, UNIX, Linux, Apple iPhone/iPad, Android, Windows Mobile, Symbian and Java platforms.

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A summary of the Company's customers that represent 10% or more of the Company's net revenues is as follows:

|                                     | Three Months Ended June 30, |       | Six Months Ended June 30, |       |
|-------------------------------------|-----------------------------|-------|---------------------------|-------|
|                                     | 2013                        | 2012  | 2013                      | 2012  |
| <b>Wireless:</b>                    |                             |       |                           |       |
| Sprint (& affiliates)               | 51.2%                       | 39.9% | 53.3%                     | 36.0% |
| Verizon Wireless (& affiliates)     | 18.4%                       | 15.6% | 16.9%                     | 20.6% |
| <b>Productivity &amp; Graphics:</b> |                             |       |                           |       |
| FastSpring                          | 15.1%                       | N/A   | 11.2%                     | N/A   |

As of June 30, 2013 these three customers listed above comprised 91% of our accounts receivable. As of June 30, 2012 the two customers listed above comprised 69% of our accounts receivable.

**Results of Operations**

The table below sets forth certain statements of comprehensive loss data expressed as a percentage of revenues for the three and six months ended June 30, 2013 and 2012. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

|  | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|--|--------------------------------|---------|------------------------------|---------|
|  | 2013                           | 2012    | 2013                         | 2012    |
| Revenues                               | 100.0%                         | 100.0%  | 100.0%                       | 100.0%  |
| Cost of revenues                       | 22.9                           | 17.7    | 21.9                         | 19.7    |
| Gross profit                           | 77.1                           | 82.3    | 78.1                         | 80.3    |
| Operating expenses:                    |                                |         |                              |         |
| Selling and marketing                  | 43.6                           | 38.9    | 40.5                         | 42.1    |
| Research and development               | 56.3                           | 60.7    | 53.6                         | 65.5    |
| General and administrative             | 46.3                           | 50.6    | 44.4                         | 52.5    |
| Restructuring expense (income)         | -                              | (0.8)   | -                            | 1.3     |
| Total operating expenses               | 146.2                          | 149.4   | 138.5                        | 161.4   |
| Operating loss                         | (69.1)                         | (67.1)  | (60.4)                       | (81.1)  |
| Interest and other income, net         | -                              | 0.3     | -                            | 0.3     |
| Loss before provision for income taxes | (69.1)                         | (66.8)  | (60.4)                       | (80.8)  |
| Provision for income tax expense       | -                              | 0.3     | 0.3                          | 0.6     |
| Net loss                               | (69.1)%                        | (67.1)% | (60.7)%                      | (81.4)% |

**Revenues and Expense Components**

The following is a description of the primary components of our revenues and expenses:

*Revenues.* Revenues are net of sales returns and allowances. Our operations are organized into two business segments:

Wireless, which includes our QuickLink<sup>®</sup>, NetWise and CommSuite<sup>®</sup> family of products; and

Productivity & Graphics, which includes our consumer-based products: Poser<sup>®</sup>, Anime Studio<sup>®</sup>, Manga Studio, MotionArtist and StuffIt

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

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|                         | Three Months Ended June 30, |                 | Six Months Ended June 30, |                  |
|-------------------------|-----------------------------|-----------------|---------------------------|------------------|
|                         | 2013                        | 2012            | 2013                      | 2012             |
| Wireless                | \$ 8,525                    | \$ 8,776        | \$ 18,746                 | \$ 17,415        |
| Productivity & Graphics | 1,959                       | 1,395           | 3,340                     | 2,870            |
| <b>Total revenues</b>   | <b>10,484</b>               | <b>10,171</b>   | <b>22,086</b>             | <b>20,285</b>    |
| Cost of revenues        | 2,401                       | 1,796           | 4,845                     | 3,991            |
| <b>Gross profit</b>     | <b>\$ 8,083</b>             | <b>\$ 8,375</b> | <b>\$ 17,241</b>          | <b>\$ 16,294</b> |

*Cost of revenues.* Cost of revenues consists of direct product costs, royalties and technical support.

*Selling and marketing.* Selling and marketing expenses consist primarily of personnel costs, advertising costs, sales commissions and trade show expenses. These expenses vary significantly from quarter to quarter based on the timing of trade shows and product introductions.

*Research and development.* Research and development expenses consist primarily of personnel and equipment costs required to conduct our software development efforts.

*General and administrative.* General and administrative expenses consist primarily of personnel costs, professional services and fees paid for external service providers, space and occupancy costs, and legal and other public company costs.

*Restructuring expense (income).* Restructuring expenses consist primarily of one-time employee termination benefits, lease and other contract terminations and costs to consolidate facilities and relocate employees.

*Interest and other income, net.* Interest and other income, net is primarily related to our average cash and short term investment balances during the period and vary among periods. Our other excess cash is invested in short term marketable equity and debt securities classified as cash equivalents.

*Provision for income tax expense.* The Company accounts for income taxes as required by Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) Topic No. 740, Income Taxes. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in the Company s financial statements or tax returns. Measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and tax bases of the Company s assets and liabilities result in a deferred tax asset, we are required to evaluate the probability of being able to realize the future benefits indicated by such asset. The deferred tax assets are reduced by a valuation allowance if, based upon all available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. Establishing, reducing or increasing a valuation allowance in an accounting period generally results in an increase or decrease in tax expense in the statement of operations. We must make significant judgments to determine the provision for income taxes, deferred tax assets and liabilities, unrecognized tax benefits and any valuation allowance to be recorded against deferred tax assets. Because of our loss position, the current provision for income tax expense consists of state income tax minimums, foreign tax withholdings and foreign income taxes.

**Three Months Ended June 30, 2013 Compared to the Three Months Ended June 30, 2012**

*Revenues.* Revenues were \$10.5 million and \$10.2 million for the three months ended June 30, 2013 and 2012, respectively, representing an increase of \$0.3 million, or 3.1%. Wireless revenues decreased \$0.3 million, or 2.9%, primarily due to lower sales of our connection manager products of \$0.7 million, partially offset by increases in our NetWise and CommSuite products of \$0.4 million. Productivity & Graphics revenues increased \$0.6 million, or 40.4% primarily due to our Poser 10 and Poser Pro 2014 releases. Due to the introduction and market acceptance of mobile hotspot devices, Tablets and Smartphones capable of functioning as a WWAN hotspot, our core connection management products continue to experience lower demand in our North American marketplace. While we have launched new wireless products that address this technology shift, they are new to the market and their rate of adoption and deployment is unknown at this time causing material uncertainty regarding the timing of our future wireless revenues.

*Cost of revenues.* Cost of revenues was \$2.4 million and \$1.8 million for the three months ended June 30, 2013 and 2012, representing an increase of \$0.6 million, or 33.7%. The increase was primarily due to the product mix in Wireless of \$0.5 million and the higher Productivity & Graphics revenue of \$0.1 million.

*Gross profit.* Gross profit was \$8.1 million, or 77.1% of revenues for the three months ended June 30, 2013, a decrease of \$0.3 million, or 3.5%, from \$8.4 million, or 82.3% of revenues for the three months ended June 30, 2012. The 5.2 percentage point decrease was primarily due to the product mix.

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*Selling and marketing.* Selling and marketing expenses were \$4.6 million and \$4.0 million for the three months ended June 30, 2013 and 2012, respectively, representing an increase of \$0.6 million, or 15.6%. This increase was primarily due to advertising and commissions on our Productivity & Graphics increased revenue of \$0.3 million, severance costs of \$0.2 million, and stock-based compensation which increased from \$0.2 million to \$0.3 million, or \$0.1 million due to the acceleration of expense related to the termination of an employee.

*Research and development.* Research and development expenses were \$5.9 million and \$6.2 million for the three months ended June 30, 2013 and 2012, respectively, representing a decrease of \$0.3 million, or 4.4%. This decrease was primarily due to lower headcount. Stock-based compensation was \$0.2 million for both three month periods ended June 30, 2013 and 2012.

*General and administrative.* General and administrative expenses were \$4.9 million and \$5.2 million for the three months ended June 30, 2013 and 2012, respectively, representing a decrease of \$0.3 million, or 5.6%. This decrease was primarily due to lower audit and legal fees of \$0.1 million, lower depreciation of \$0.1 million, and lower stock-based compensation which decreased from \$0.6 million to \$0.5 million, or \$0.1 million.

*Restructuring expense (income).* There was no restructuring expense recorded in the three months ended June 30, 2013. Restructuring income was \$0.1 million for the three months ended June 30, 2012 due to the return to profit of \$0.1 million as a result of lower one-time employee termination benefits and relocation expenses related to our 2012 Restructuring Plan.

*Interest and other income, net.* Interest and other income was de minimis for both of the three months ended June 30, 2013 and 2012.

*Provision for income tax expense.* We recorded income tax expense of \$4,000 and \$32,000 for the three months ended June 30, 2013 and 2012, respectively. The income tax expenses for both periods only reflect state income tax minimums and foreign income taxes.

***Six Months Ended June 30, 2013 Compared to the Six Months Ended June 30, 2012***

*Revenues.* Revenues were \$22.1 million and \$20.3 million for the six months ended June 30, 2013 and 2012, respectively, representing an increase of \$1.8 million, or 8.9%. Wireless revenues increased \$1.3 million, or 7.6%, primarily due to increases in our NetWise and CommSuite product lines of \$3.0 million partially offset by lower sales of our connection manager products of \$1.7 million. Productivity & Graphics revenues increased \$0.5 million, or 16.4% primarily due to increases in our core product lines of Poser, Anime Studio, and Manga Studio. Due to the introduction and market acceptance of mobile hotspot devices, Tablets and Smartphones capable of functioning as a WWAN hotspot, our core connection management products continue to experience lower demand in our North American marketplace. While we have launched new wireless products that address this technology shift, they are new to the market and their rate of adoption and deployment is unknown at this time causing material uncertainty regarding the timing of our future wireless revenues.

*Cost of revenues.* Cost of revenues was \$4.9 million and \$4.0 million for the six months ended June 30, 2013 and 2012, representing an increase of \$0.9 million, or 21.4%. The increase was primarily due to the product mix in Wireless of \$0.8 million and the higher Productivity & Graphics revenue of \$0.1 million.

*Gross profit.* Gross profit was \$17.2 million, or 78.1% of revenues for the six months ended June 30, 2013, an increase of \$0.9 million, or 5.8%, from \$16.3 million, or 80.3% of revenues for the six months ended June 30, 2012. The 2.2 percentage point decrease was primarily due to the product mix.

*Selling and marketing.* Selling and marketing expenses were \$9.0 million and \$8.6 million for the six months ended June 30, 2013 and 2012, respectively, representing an increase of \$0.4 million, or 4.7%. This increase was primarily due to severance costs of \$0.2 million, advertising and commissions on our Productivity & Graphics increased revenue of \$0.1 million, and stock-based compensation which increased from \$0.5 million to \$0.6 million, or \$0.1 million due to the acceleration of expense related to the termination of an employee.

*Research and development.* Research and development expenses were \$11.8 million and \$13.3 million for the six months ended June 30, 2013 and 2012, respectively, representing a decrease of \$1.5 million, or 10.9%. This decrease was primarily due to lower headcount. Stock-based compensation was \$0.4 million for both six month periods ended June 30, 2013 and 2012.

*General and administrative.* General and administrative expenses were \$9.8 million and \$10.7 million for the six months ended June 30, 2013 and 2012, respectively, representing a decrease of \$0.9 million, or 8.0%. This decrease was primarily due to lower space & occupancy costs of \$0.3 million, lower audit and legal fees of \$0.2 million, lower depreciation of \$0.2 million, and lower stock-based compensation which decreased from \$1.3 million to \$1.1 million, or \$0.2 million.



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*Restructuring expense (income).* There was no restructuring expense recorded in the six months ended June 30, 2013. Restructuring expense was \$0.3 million for the six months ended June 30, 2012 primarily related to severance and relocation costs related to our 2012 Restructuring Plan.

*Interest and other income, net.* Interest and other income was de minimis and \$0.1 million for the six months ended June 30, 2013 and 2012, respectively.

*Provision for income tax expense.* We recorded income tax expense of \$0.1 million for the both six months ended June 30, 2013 and 2012. These amounts only reflect state income tax minimums and foreign income taxes.

## **Liquidity and Capital Resources**

At June 30, 2013, we had \$23.5 million in cash and cash equivalents and short-term investments and \$24.7 million of working capital.

In November 2011, the Company announced that its Board of Directors had approved a program authorizing the repurchase of up to five million shares of the Company's common stock over a period of up to two years. Under this program, stock repurchases may be made from time to time and the actual amount expended will depend on a variety of factors including market conditions, regulatory and legal requirements, corporate cash generation and other factors. The stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of Rule 10b5-1 trading plans. The program does not obligate Smith Micro to repurchase any particular amount of common stock during any period and the program may be modified or suspended at any time at the Company's discretion. During the six months ended June 30, 2013 we did not repurchase any shares. During the six months ended June 30, 2012, we repurchased 375,000 shares at a cost of \$0.8 million.

Capital expenditures were \$0.1 million for both six month periods ended June 30, 2013 and 2012.

We believe that our existing cash, cash equivalents and short-term investment balances will be sufficient to finance our working capital and capital expenditure requirements through at least the next twelve months. We are hopeful that our new products will gain market acceptance in order to increase our revenues in upcoming quarters. If our new products do not gain market acceptance, or market acceptance is slower than anticipated, then we anticipate that it will be necessary to undertake additional restructuring to lower costs to bring them more in line with actual revenues, thus slowing the usage of cash. We may require additional funds to support our working capital requirements or for other purposes and may seek to raise additional funds through public or private equity or debt financing or from other sources. If additional financing is needed, we cannot assure that such financing will be available to us at commercially reasonable terms or at all.

## *Operating activities*

Net cash used in operating activities was \$8.6 million for the six months ended June 30, 2013. The primary uses of operating cash were to fund our net loss of \$13.4 million and decreases in our prepaid expenses of \$0.4 million. These were partially offset by non-cash expenses including depreciation and amortization of \$2.1 million, stock-based compensation of \$1.9 million, accounts receivable and inventory reserves of \$0.4 million, increases in accounts payable and accrued expenses of \$0.6 million, and decreases in other assets of \$0.2 million.

Net cash used in operating activities was \$14.0 million for the six months ended June 30, 2012. The primary uses of operating cash were to fund our net loss of \$16.5 million, and decreases in our accounts payable and accrued expenses of \$2.4 million and accounts receivable of \$0.4 million. These were partially offset by non-cash expenses including

depreciation and amortization of \$2.2 million, stock-based compensation of \$2.2 million, state income tax refunds of \$0.6 million, and other account adjustments of \$0.3 million.

*Investing activities*

Net cash used in investing activities was \$1.1 million for the six months ended June 30, 2013 due to the purchase of short-term investments of \$1.0 million and capital expenditures of \$0.1 million.

During the six months ended June 30, 2012, we were provided with \$18.2 million in investing activities due to the sale of short-term investments of \$18.3 million, partially offset by capital expenditures of \$0.1 million.

**Table of Contents***Financing activities*

During the six months ended June 30, 2013, we received \$21,000 from the stock sale for the employee stock purchase plan.

During the six months ended June 30, 2012, we used \$0.8 million to repurchase our common stock and received \$0.1 million from the stock sale for the employee stock purchase plan.

*Contractual obligations and commercial commitments*

As of June 30, 2013 we had no debt. The following table summarizes our contractual obligations as of June 30, 2013 (in thousands):

| <b>Contractual obligations:</b> | <b>Total</b>     | <b>Payments due by period</b> |                  |                  |                              |
|---------------------------------|------------------|-------------------------------|------------------|------------------|------------------------------|
|                                 |                  | <b>1 year<br/>or less</b>     | <b>1-3 years</b> | <b>3-5 years</b> | <b>More than<br/>5 years</b> |
| Operating Lease Obligations     | \$ 16,561        | \$ 2,612                      | \$ 4,897         | \$ 3,638         | \$ 5,414                     |
| Purchase Obligations            | 1,465            | 1,465                         | -                | -                | -                            |
| <b>Total</b>                    | <b>\$ 18,026</b> | <b>\$ 4,077</b>               | <b>\$ 4,897</b>  | <b>\$ 3,638</b>  | <b>\$ 5,414</b>              |

During our normal course of business, we have made certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These include: intellectual property indemnities to our customers and licensees in connection with the use, sale and/or license of our products; indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease; indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct; indemnities involving the accuracy of representations and warranties in certain contracts; and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware. We may also issue a guarantee in the form of a standby letter of credit as security for contingent liabilities under certain customer contracts. The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees may not provide for any limitation of the maximum potential for future payments we could be obligated to make. We have not recorded any liability for these indemnities, commitments and guarantees in the accompanying consolidated balance sheets.

*Real Property Leases*

Our corporate headquarters, including our principal administrative, sales and marketing, customer support and research and development facility, is located in Aliso Viejo, California, where we currently lease and occupy approximately 52,700 square feet of space pursuant to leases that expire on May 31, 2016 and January 31, 2022. We lease approximately 55,600 square feet in Pittsburgh, Pennsylvania under a lease that expires December 31, 2021. We lease approximately 16,000 square feet in Sunnyvale, California under a lease that expires February 28, 2015. We lease approximately 15,300 square feet in Watsonville, California under a lease that expires September 30, 2018. Internationally, we lease space in Belgrade, Serbia that expires December 30, 2016 and Vancouver, Canada that expires March 31, 2014.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of results of operations, financial condition and liquidity are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may materially differ from these estimates under different assumptions or conditions. On an on-going basis, we review our estimates to ensure that the estimates appropriately reflect changes in our business or new information as it becomes available.

We believe the following critical accounting policies affect our more significant estimates and assumptions used in the preparation of our consolidated financial statements:

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**Table of Contents***Revenue Recognition*

We currently report our net revenues under two operating groups: Wireless and Productivity & Graphics. Within each of these groups software revenue is recognized based on the customer and contract type. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectability is probable as required by FASB ASC Topic No. 985-605, Software-Revenue Recognition. We recognize revenues from sales of our software to our customers or end users as completed products are shipped and titles passes; or from royalties generated as authorized customers duplicate our software, if the other requirements are met. If the requirements are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. For Wireless sales, returns from customers are limited to defective goods or goods shipped in error. Historically, customer returns have not exceeded the very nominal estimates and reserves. We also provide some technical support to our customers. Such costs have historically been insignificant.

We have a few multiple element agreements for which we have contracted to provide a perpetual license for use of proprietary software, to provide non-recurring engineering, and in some cases to provide software maintenance (post contract support). For these software and software-related multiple element arrangements, we must: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine the fair value of each undelivered element using vendor-specific objective evidence ( VSOE ), and (4) allocate the total price among the various elements. VSOE of fair value is used to allocate a portion of the price to the undelivered elements and the residual method is used to allocate the remaining portion to the delivered elements. Absent VSOE, revenue is deferred until the earlier of the point at which VSOE of fair value exists for any undelivered element or until all elements of the arrangement have been delivered. However, if the only undelivered element is post contract support, the entire arrangement fee is recognized ratably over the performance period. We determine VSOE for each element based on historical stand-alone sales to third parties or from the stated renewal rate for the elements contained in the initial arrangement. In determining VSOE, we require that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range. We have established VSOE for our post contract support services and non-recurring engineering.

For Productivity & Graphics sales, management reviews available retail channel information and makes a determination of a return provision for sales made to distributors and retailers based on current channel inventory levels and historical return patterns. Certain sales to distributors or retailers are made on a consignment basis. Revenue for consignment sales are not recognized until sell through to the final customer is established. Certain revenues are booked net of revenue sharing payments. Sales directly to end-users are recognized upon shipment. End users have a thirty day right of return, but such returns are reasonably estimable and have historically been immaterial. We also provide technical support to our customers. Such costs have historically been insignificant.

*Accounts Receivable and Allowance for Doubtful Accounts*

We sell our products worldwide. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history, the customer's current credit worthiness and various other factors, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers. We estimate credit losses and maintain an allowance for doubtful accounts reserve based upon these estimates. While such credit losses have historically been within our estimated reserves, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. If not, this could have an adverse effect on our consolidated financial statements.

*Impairment or Disposal of Long Lived Assets*

Long-lived assets to be held are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. They are tested for recoverability using undiscounted cash flows to determine whether or not impairment to such value has occurred as required by FASB ASC Topic No. 360, Property, Plant, and Equipment. The Company has determined that there was no impairment at June 30, 2013.

*Income Taxes*

We account for income taxes as required by FASB ASC Topic No. 740, Income Taxes. This Topic clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Topic also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Topic requires an entity to recognize the financial statement impact of a tax position when it is more likely than not that the position will be sustained upon examination. The amount recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. In addition, the Topic permits an entity to recognize interest and penalties related to tax uncertainties either as income tax expense or operating expenses. The Company has chosen to recognize interest and penalties related to tax uncertainties as operating expense.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Interest Rate Risk*

Our financial instruments include cash and cash equivalents and short-term investments. At June 30, 2013, the carrying values of our financial instruments approximated fair values based on current market prices and rates.

*Foreign Currency Risk*

While a majority of our business is denominated in U.S. dollars, we do invoice in foreign currencies. For the three months ended June 30, 2013 and 2012, our revenues denominated in foreign currencies were zero and \$0.2 million, respectively. For the six months ended June 30, 2013 and 2012, our revenues denominated in foreign currencies were \$0.1 million and \$0.2 million, respectively. Fluctuations in the rate of exchange between the U.S. dollar and certain other currencies may affect our results of operations and period-to-period comparisons of our operating results. We do not currently engage in hedging or similar transactions to reduce these risks. The operational expenses of our foreign entities reduce the currency exposure we have because our foreign currency revenues are offset in part by expenses payable in foreign currencies. As such, we do not believe we have a material exposure to foreign currency rate fluctuations at this time.

**Item 4. Controls and Procedures**

*Evaluation of disclosure controls and procedures*

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 ( Exchange Act )) as of June 30, 2013. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have determined that as of June 30, 2013, our disclosure controls and procedures were effective to ensure that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

*Management's responsibility for financial statements*

Our management is responsible for the integrity and objectivity of all information presented in this report. The consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America and include amounts based on management's best estimates and judgments. Management believes the consolidated financial statements fairly reflect the form and substance of transactions and that the financial statements fairly represent the Company's financial position and results of operations for the periods and as of the dates stated therein.

The Audit Committee of the Board of Directors, which is composed solely of independent directors, meets regularly with our independent registered public accounting firm, SingerLewak LLP, and representatives of management to

review accounting, financial reporting, internal control and audit matters, as well as the nature and extent of the audit effort. The Audit Committee is responsible for the engagement of the independent auditors. The independent auditors have free access to the Audit Committee.

*Changes in internal control over financial reporting*

There have been no changes in our internal controls over financial reporting during the quarter ended June 30, 2013 that have materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.



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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company is and may become involved in various legal proceedings arising from its business activities. While management does not believe the ultimate disposition of these matters will have a material adverse impact on the Company's consolidated results of operations, cash flows or financial position, litigation is inherently unpredictable, and depending on the nature and timing of these proceedings, an unfavorable resolution could materially affect the Company's future consolidated results of operations, cash flows or financial position in a particular period.

**Item 1A. Risk Factors**

You should carefully consider and evaluate all of the information in this Quarterly Report and the risk factors set forth below and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, which was filed with the SEC on February 20, 2013 (the Form 10-K). The risks set forth below and in our Form 10-K are not the only ones that we face. Additional risks that are not known to us or that we currently deem immaterial may also impair our business operations. If any of these risks actually occur, our business could be materially harmed and the trading price of our common stock could decline. Please also refer to Management's Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report for a discussion of certain factors that may affect our future performance.

Except for the updated risk factors below, the risk factors associated with our business have not materially changed compared to the risk factors disclosed in the Form 10-K.

*We derive a significant portion of our revenues from sales of a small number of products to Sprint and Verizon Wireless, so our revenues and operating results are highly vulnerable to shifts in demand.*

We sell primarily to large carriers and original equipment manufacturers (OEMs), so there are a limited number of actual and potential customers for our products, resulting in customer concentration for sales of our products and services. For the year ended December 31, 2012, sales to Sprint and Verizon Wireless comprised 40.7% and 20.5% of our total revenues, respectively. For the six months ended June 30, 2013, sales to Sprint and Verizon Wireless comprised 53.3% and 16.9% of our total revenues, respectively. Because of our customer concentration, these carriers and other large customers may have significant pricing power over us, and any material decrease in sales to any of them would materially affect our revenues and profitability. Additionally, carriers and OEMs are not the end-users of our products. If any of their efforts to market products and services incorporating our software are unsuccessful in the marketplace, our revenues and profitability could be adversely affected.

On July 10, 2013, the Softbank and Sprint Nextel merger was completed which could further intensify the competitive pressures that we face. Furthermore, the uncertainties created by this merger could cause it to delay or cancel planned purchases of our products and services, particularly if there are proposed changes or uncertainties in the future management, product offerings and technical specifications of Sprint and its product portfolio.

*We recently announced a restructuring plan and we may take additional restructuring actions in the future that would result in additional charges, which would have a negative impact on our results of operations in the period the action is taken.*

On July 25, 2013, the Board of Directors approved a new restructuring plan to be implemented primarily during the fiscal quarter ending September 30, 2013. This restructuring plan involves changes in management structure in order to streamline the organization, facility consolidations/closures, and headcount reductions that will amount to approximately 25-30% of the Company's worldwide workforce. This will result in one-time restructuring charges of approximately \$5.0-6.8 million that will be recorded in the fiscal quarter ending September 30, 2013. If the demand for our legacy and new products does not increase, we may need to take additional restructuring actions in future quarters, although we currently do not have any intention to do so. If future restructuring actions are taken, this could have a material adverse effect on our financial condition and results of operations in the period that the action is taken.

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*Our restructuring plan includes organizational changes and facility closures and consolidations, which could have a negative impact on our operations and customers.*

Our recently announced restructuring plan will involve a transfer of significant duties and responsibilities from employees who are being terminated and facilities which are being closed or consolidated. Such duties and responsibilities will be transferred to employees and facilities which we are retaining. If the transfer of duties and responsibilities, including underlying product knowledge and expertise of our existing product lines, is not executed successfully and seamlessly, this could adversely affect our levels of customer service and satisfaction, which could adversely affect our business and future revenues. In addition, the restructuring may cause us future difficulties in hiring and retaining highly skilled employees, particularly in competitive specialties.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The table set forth below shows all repurchases of securities by us during the three months ended June 30, 2013:

**ISSUER PURCHASES OF EQUITY SECURITIES**

| Period          | Total<br>Number<br>of<br>Shares (or<br>Units)<br>Purchased | Average<br>Price<br>Paid per<br>Share (or<br>Unit) | Total Number<br>of Shares (or<br>Units)<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs |  | Maximum Number<br>(or Approximate<br>Dollar Value) of<br>Shares (or Units)<br>that May Yet Be<br>Purchased Under<br>the Plans or<br>Programs |
|-----------------|--|--|---|--|--|
|                 |  |  |   |  |  |
| Apr. 1-30, 2013 |  |  |   |  |  |
| May 1-31, 2013  |  |  |   |  |  |
| Jun 1-30, 2013  | 29,681(a)  | \$1.38   |   |  |  |
| Total           | 29,681   | \$1.38   |   |  | 4,625,000 (b)  |

The above table includes:

(a) Acquisition of stock by the Company as payment of withholding taxes in connection with the vesting of restricted stock awards, in an aggregate amount of 29,681 shares during the periods set forth in the table.

(b) Repurchases of stock under a program announced on November 2, 2011 authorizing the repurchase by the Company of up to 5,000,000 shares over a period of up to two years. Under this program, stock repurchases may be made from time to time and the actual amount expended will depend on a variety of factors including market

conditions, regulatory and legal requirements, corporate cash generation and other factors. The stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of Rule 10b5-1 trading plans. The program does not obligate the Company to repurchase any particular amount of common stock during any period and the program may be modified or suspended at any time at the Company's discretion. During the three months ended June 30, 2013, we did not repurchase any shares.

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**Item 6. Exhibits**

|           |   |
|-----------|---|
| 31.1      | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2      | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1      | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                            |
| 101.INS** | XBRL Instance Document  |
| 101.SCH** | XBRL Taxonomy Extension Schema Document   |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document  |

\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SMITH MICRO SOFTWARE, INC.

August 2, 2013

By /s/ William W. Smith, Jr.  
William W. Smith, Jr.  
President and Chief Executive Officer  
*(Principal Executive Officer)*

August 2, 2013

By /s/ Andrew C. Schmidt  
Andrew C. Schmidt  
Vice President and Chief Financial Officer  
*(Principal Financial Officer)*