SMITH MICRO SOFTWARE INC
Form 10-K
February 27, 2015
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2014

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

For the transition period from __________ to __________

Commission File Number 01-35525

SMITH MICRO SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**33-0029027**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
51 Columbia, Aliso Viejo, CA	**92656**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (949) 362-5800

Common Stock, $.001 par value	**The NASDAQ Stock Market LLC (NASDAQ Global Market)**
(Title of each class)	**(Name of each exchange on which registered)**

Securities registered pursuant to Section 12(b) of the Act: Common Stock, $.001 par value

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 YES ¨ NO x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K ¨

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

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

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

As of June 30, 2014, the last business day of the registrant s most recently completed second quarter, the aggregate market value of the common stock of the registrant held by non-affiliates was $34,209,212 based upon the closing sale price of such stock as reported on the Nasdaq Global Market on that date. For purposes of such calculation, only executive officers, board members, and beneficial owners of more than 10% of the registrant s outstanding common stock are deemed to be affiliates.

As of February 20, 2015, there were 45,004,146 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for the 2015 Annual Meeting of Stockholders to be filed under the Securities Exchange Act of 1934 are incorporated by reference in Part III of this report.

Table of Contents

SMITH MICRO SOFTWARE, INC.

2014 ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

PART I

Item 1.	BUSINESS	4
Item 1A.	RISK FACTORS	10
Item 1B.	UNRESOLVED STAFF COMMENTS	19
Item 2.	PROPERTIES	19
Item 3.	LEGAL PROCEEDINGS	19
Item 4.	MINE SAFETY DISCLOSURES	19

PART II

Item 5.	MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	20
Item 6.	SELECTED CONSOLIDATED FINANCIAL DATA	23
Item 7.	MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	24
Item 7A.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	34
Item 8.	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	35
Item 9.	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	35
Item 9A.	CONTROLS AND PROCEDURES	35
Item 9B.	OTHER INFORMATION	36

PART III

Item 10.	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	37
Item 11.	EXECUTIVE COMPENSATION	39
Item 12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	39
Item 13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	39
Item 14.	PRINCIPAL ACCOUNTING FEES AND SERVICES	39

PART IV

Item 15.	EXHIBITS AND FINANCIAL STATEMENT SCHEDULES	40

SIGNATURES	44

Table of Contents

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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:

- *our customer concentration given that the majority of our sales depend on a few large client relationships, including Sprint;*
- *the risk of being delisted from the NASDAQ Global Select Market if we fail to meet any of the listing requirements;*
- *changes in demand for our products from our key customers and their end-users;*
- *the intensity of the competition and our ability to successfully compete;*
- *the pace at which the market for new products develop;*
- *our ability to hire and retain key personnel;*
- *the availability of third party intellectual property and licenses which may not be on commercially reasonable terms, or not at all;*
- *our ability to establish and maintain strategic relationships with our customers;*

- *our quarterly revenues and operating results are difficult to predict and could fall below analyst or investor expectations, which could cause the price of our common stock to fall;*
- *our ability to protect our intellectual property and our ability to not infringe on the rights of others;*
- *our ability to raise additional capital to fund our operations and such capital may not be available to us at commercially reasonable terms or at all;*
- *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 section 1A. Risk Factors beginning on page 10 of this report.*

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.

3

Table of Contents

PART I

Item 1. BUSINESS

General

Smith Micro provides software solutions to simplify and enhance the mobile experience. As a leader in wireless connectivity, our applications ensure the best Quality of Experience for mobile users while optimizing networks for wireless service providers and enterprises. Using our intelligent policy-on-device platform, along with premium voice, video and content monetization services, we create new opportunities to engage consumers and capitalize on the growth of connected devices. In addition to wireless and mobility software, Smith Micro develops and distributes personal, professional and educational productivity and graphics products and tools for consumers, artists, animators and designers worldwide.

Over the past three decades, the Company has developed deep expertise in embedded software for networked devices, policy-based management platforms, and highly-scalable mobile applications and hosted services. For organizations struggling to reduce costs and complexity in the fragmented, rapidly evolving mobile market, Smith Micro offers proven solutions that increase reliability and efficiency while accelerating delivery and value of mobile services to consumers.

The proliferation of mobile broadband technology continues to provide new opportunities for Smith Micro on a global scale. Smith Micro s mission is to help our customers thrive in a connected world with software solutions that:

1. Simplify wireless connectivity to reduce costs and deliver best-connected experiences;
2. Optimize network and device resources for maximum performance, efficiency and flexibility;
3. Provide greater insight and control over the quality of service (QoS) delivered to users; and
4. Engage and grow high-value relationships with end customers using mobile devices.

The Company was incorporated in California in November 1983, and reincorporated in Delaware in June 1995. Our principal executive offices are located at 51 Columbia, Aliso Viejo, California 92656. Our telephone number is (949) 362-5800. Our website address is www.smithmicro.com. Our NASDAQ symbol is SMSI, and we make our SEC filings available on the Investor Relations page of our website. Information contained on our website is not part of this Annual Report on Form 10-K.

Business Segments

Our operations are organized into two business segments: Wireless and Productivity & Graphics. We do not separately allocate operating expenses, nor do we allocate specific assets to these groups. Therefore, segment information reported includes only revenues and cost of revenues. See Note 6 of Notes to Consolidated Financial Statements for financial information related to our business segments and geographical information.

Table of Contents

Wireless

The wireless industry continues to undergo rapid change on all fronts, from the growing expanse of heterogeneous networks, to the vast array of connected devices, to the endless barrage of mobile applications and digital content especially video consumed by users who want information and entertainment anytime, anywhere. While most of us think about being connected in terms of computers, tablets and smartphones, the emerging Internet of Things (IoT) market is creating a world where almost anything can be connected to the wireless internet.

Although the opportunities associated with pervasive connectivity are plenty, so are the challenges:

- Complexity, congestion and spectrum scarcity plague wireless networks, making mobile data access inconsistent, unreliable and expensive for consumers and businesses.
- Mobile Network Operators are being marginalized by over-the-top applications, social networks and Wi-Fi providers as they struggle to differentiate while facing tremendous price pressure.
- Enterprises face increasing pressure to mobilize workforces, operations and customer engagement, but lack the expertise and technologies needed to leverage mobile securely and cost-effectively.
- Consumers - frustrated by complicated, slow and restrictive access to wireless data services seek simpler, more personalized mobile experiences.

To address these challenges, Smith Micro offers three product families that help our customers *connect, control* and *capitalize* on the mobile internet:

QuickLink® applications for connecting consumer and machine-to-machine (M2M) devices to 3G, 4G and Wi-Fi networks, easily and reliably, while managing their data usage.

NetWise® policy-on-device platform for controlling device behavior, optimizing data traffic, engaging mobile users, and improving quality of experience over wireless networks.

CommSuite® premium voice, messaging and video services that allow operators and enterprises to flexibly deliver and monetize apps and content.

Our QuickLink connectivity solutions have been shipped on more than 100 million devices worldwide. Many of the world s largest mobile network operators, including AT&T, Bell Canada, Orange, Sprint, T-Mobile, Verizon Wireless, and Vodafone, have offered QuickLink as a white-label connection management application to their subscribers. QuickLink components are embedded by leading chipset manufacturers and module makers to ensure that connectivity is consistent across device types. QuickLink is also used by enterprises and public sector organizations with mobile workforces to provide enhanced security and configurability over public and private wireless networks.

NetWise provides visibility and control over 3G, 4G and Wi-Fi network connections to ensure the best possible quality of experience for end users. NetWise helps operators reduce congested cellular networks with efficient Wi-Fi offload, while also facilitating Wi-Fi on-load for broadband providers who are extending services outside of the home.

Used by several Tier 1 operators and broadband providers in the U.S., Latin America and Asia, NetWise provides the device intelligence and a management platform to maximize service uptake and performance. For retailers and other consumer service providers, NetWise offers a new way to engage consumers with more personalized, context-based mobile promotions.

The CommSuite premium services platform gives operators new ways to drive revenues and better compete with over-the-top (OTT) applications. It offers innovative features, such as Voice-to-Text transcription, Avatar messaging, and Videomail, while supporting flexible business models, including freemium try-and-buy offers, monthly subscriptions, content purchases, and ad-sponsored user engagement. CommSuite also enables efficient, high-performance streaming of mobile video content for entertainment, hospitality, large venues, and other industries.

Table of Contents

Over the past three decades, Smith Micro has developed unmatched expertise in mobile device software, integration to operator services, and wireless industry standards. Our ability to customize solutions that meet stringent reliability and security requirements for Tier 1 operators makes us the preferred choice for any company that wants more out of mobile.

Productivity & Graphics

The Productivity & Graphics group develops a variety of software, including graphic design and animation, compression and PC/Mac utilities, for consumers, professional artists, and educators. This group also republishes and markets third-party software that complements the Company s existing line of products. These products are available through direct sales on Smith Micro websites (smithmicro.com, mysmithmicro.com and contentparadise.com), as well as through affiliate websites, resellers and retail outlets.

The group s primary focus is its line of graphic titles, in particular Poser®, Anime Studio®, Manga Studio® and MotionArtist . These products are aimed at digital artists and designers of all skill levels, helping them to produce professional quality animations, comics, and other 2D and 3D art. Poser is the industry leading tool for 3D human figure design and animation. Anime Studio is used by both hobbyists and professional artists working for high-end animation studios in the motion picture industry, and Manga Studio is at the top of the market for comic illustration software, used by famous graphic novelists such as Dave Gibbons, the author of the Watchmen. The group is enhancing and mobilizing these solutions to extend to new markets including gaming, industrial design, digital content, and more.

Products and Services

Our primary products consist of the following:

Product Groups	Products	Description
Wireless	QuickLink® Mobile	Connection management application to control, customize and automate wireless connections from PCs and Macs to WWAN and WLAN/Wi-Fi networks
	QuickLink® Mobility	Mobile VPN and connection manager targeted to enterprises with mobile workforces and the public sector
	QuickLink® Zero	Streamlined connectivity for mobile hotspot features on smartphones and mobile broadband devices, with billing integration, automated diagnostics, usage metering and data management
	QuickLink® MiTile	Connection manager for Microsoft Windows 8 devices
	QuickLink® MBIM Middleware	Customizable drivers that support the Mobile Broadband Interface Model (MBIM) standard for connecting USB devices to a variety of operating systems
	NetWise® Director	Intelligent traffic management for data offload and seamless, secure access to 3G/4G/Wi-Fi networks

NetWise® I/O	A toolkit for testing client/server interoperability using the ANDSF networking standard
NetWise® SmartSpot	Wi-Fi discoverability, promotion and automated authentication
NetWise® Captivate	Mobile marketing platform that uses real-time conditions, events, location and analytics to better engage customers
NetWise® FOTA	Lightweight device agent and deployment server for updating Firmware Over The Air (FOTA)

Table of Contents

	CommSuite® PTT	A push-to-talk (PTT) data service that uses a mobile Internet connection to send and receive walkie-talkie style calls
	CommSuite® VVM	Visual Voicemail (VVM) delivered directly to a mobile phone app and managed like email
	CommSuite® VTT	Voice-to-Text (VTT) transcription of voicemail and voice SMS messages
	CommSuite® Avatars	Talking Avatars that let users lip-synch a message with voice effects, backgrounds, stickers and photos to personalize mobile communications
	CommSuite® VIDIO	Adaptive streaming of live or pre-recorded video content to support mobile viewing across laptops, tablets, phones, TVs, and more
	CommSuite® Videomail	Creation of video messages that can be delivered to any user via phone, SMS, email or web link, with no client software required
	AniMates®	Mobile messaging app for iOS and Android smartphones that lets users send personalized Avatar messages with fun voice effects and backgrounds
Productivity & Graphics	Poser®	3D animation software for character art, animation and digital design
	Poser Pro Game Dev	3D character creator and animation tools, plus real-time ready character content to game and interactive content developers to reduce game development time and improve the overall game experience
	Anime Studio®	2D animation software for digital artists
	Manga Studio®	Graphics software for creating manga and comic art
	MotionArtist	A fast, easy solution for creating interactive presentations
	ScatterShow	Creates slide shows from photo albums on mobile devices
	StuffIt Deluxe®	A patented, lossless compression solution for documents and media
	Sock Puppets	iOS app to create lip-synched cartoons and share them on Facebook and YouTube

Marketing and Sales Strategy

Because of our broad product portfolio, deep integration experience, and flexible business models, we can quickly bring to market innovative solutions that support our customers needs to create new revenue opportunities and differentiate their products and services among their competitors.

Our sales strategy is as follows:

Leverage Operator and OEM Relationships. We continue to capitalize on our strong relationships with the world s leading mobile network operators (MNOs), multiple service operators (MSOs), and device manufacturers. These customers serve as our primary distribution channel, providing access to hundreds of millions of end-users around the world.

Focus on High-Growth Markets. We continue to focus on wireless connectivity solutions and premium mobile services, taking advantage of expanding 4G and Wi-Fi networks, as well as the explosive growth of smartphones, tablets, M2M and other mobile devices.

Expand our Customer Base. In addition to growing business with current customers, we are adding new customers through reseller partners and increased penetration of the enterprise market, with particular focus on public safety, retail, and vertical markets utilizing M2M technologies.

Selectively Pursue Partners with Complementary Products and Services. We continue to pursue partnerships to help us enter new markets and extend our geographic reach. We will engage technology providers and systems integrators to deliver more comprehensive solutions to our customers.

Revenues to Sprint and their respective affiliates in the Wireless business segment accounted for 68.0% of the Company s total revenues for the fiscal year 2014. Revenues to FastSpring in the Productivity & Graphics business segment accounted for 11.2% of the Company s total revenues for the fiscal year 2014. Revenues to two customers (Sprint and Verizon Wireless) and their respective affiliates in the Wireless business segment accounted for 53.1% and 13.0%, respectively, of the Company s total revenues for the fiscal year 2013. Revenues to FastSpring in the Productivity & Graphics business segment accounted for 11.4% of the Company s total revenues for the fiscal year 2013. In 2012, our two largest customers (Sprint and Verizon Wireless) accounted for 40.7% and 20.5%, respectively, of our total revenues. Our major customers could reduce their orders of our products in favor of a competitor s product or for any other reason. The loss of any of our major customers or decisions by a significant customer to substantially reduce purchases could have a material adverse effect on our business.

Customer Service and Technical Support

We provide technical support and customer service through our online knowledge base, via email and live chat. OEM customers generally provide their own primary customer support functions and rely on us for support to their own technical support personnel.

Product Development

The software industry, particularly the wireless market, is characterized by rapid and frequent changes in technology and user needs. We work closely with industry groups and customers, both current and potential, to help us anticipate changes in technology and determine future customer needs. Software functionality depends upon the capabilities of the hardware. Accordingly, we maintain engineering relationships with various hardware manufacturers and we develop our software in tandem with their product development. Our engineering relationships with manufacturers, as well as with our major customers, are central to our product development efforts. We remain focused on the development and expansion of our technology, particularly in the wireless space. Research and development expenditures amounted to $14.2 million, $21.3 million, and $24.8 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Manufacturing

Although we primarily deliver our software via electronic downloads, we do deliver our software in several other forms. We offer a package or kit that may include CD-ROMs and certain other documentation or marketing material. We also permit selected OEM customers to duplicate our products on their own CD-ROMs, USB devices, or embedded devices, and pay a royalty based on usage. Some OEM business requires that we provide a CD, which includes a soft copy of a user guide. Finally, we grant licenses to certain OEM customers that enable those customers to preload a copy of our software onto a personal computer. With the enterprise sales program, we offer site licenses under which a corporate user is allowed to distribute copies of the software to users within their corporate sites.

Our product development group produces a product master for each product that is then duplicated and packaged into products by the manufacturing organization. All product components are purchased by our personnel in our Aliso Viejo, California facility. Our manufacturing is subcontracted to outside vendors and includes the replication of CD-ROMs and the printing of documentation materials. Assembly of the final package is completed by our Aliso Viejo, California facility.

Table of Contents

Competition

The markets in which we operate are highly competitive and subject to rapid changes in technology. These conditions create new opportunities for Smith Micro, as well as for our competitors, and we expect new competitors to enter the market. We will not only compete with other software vendors for new customer contracts, we will also compete to acquire technology and qualified personnel.

We believe that the principal competitive factors affecting the mobile software market include domain expertise, product features, usability, quality, price, customer service and effective sales and marketing efforts. Although we believe that our products currently compete favorably with respect to these factors, there can be no assurance that we can maintain our competitive position against current and potential competitors. We also believe that the market for our software products has been and will continue to be characterized by significant price competition. A material reduction in the price of our products could negatively affect our profitability.

Many existing and potential customers have the resources to develop products that compete directly with our products. These customers may discontinue the purchase of our products. Our future performance is substantially dependent upon the extent to which existing customers elect to purchase software from us rather than design and develop their own software.

Proprietary Rights and Licenses

Our success and ability to compete is dependent upon our software code base, our programming methodologies and other intellectual properties. To protect our proprietary technology and intellectual property, we rely on a combination of trade secrets, nondisclosure agreements, patents, copyright and trademark law that may afford only limited protection. As of December 31, 2014, we owned 85 issued U.S. patents and have 20 U.S. patent applications that are currently pending. These patents are intended to provide generalized protection of our intellectual property technology base and we will continue to apply for various patents and trademarks in the future as we deem necessary to protect our intellectual property technology base.

We seek to avoid unauthorized use and disclosure of our proprietary intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements with us and by restricting access to our source code. The deterrent steps that we have taken to protect our proprietary technology may not be adequate to deter misappropriation of our proprietary information or prevent the successful assertion of any adverse claim against us relating to software or intellectual property utilized by us. In addition, we may not be able to detect unauthorized use of our intellectual property rights or take effective steps to enforce those rights.

In selling our products, we primarily rely on shrink wrap licenses that are not signed by licensees and may be unenforceable under the laws of certain jurisdictions. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as do the laws of the United States. Accordingly, the means we currently use to protect and enforce all of our proprietary rights and intellectual property rights may not be adequate. Moreover, our competitors may independently develop competitive technology similar to ours. We also license technology on a non-exclusive basis from several companies for inclusion in our products and anticipate that we will continue to do so in the future. If we are unable to continue to license these technologies or to license other necessary technologies for inclusion in our products, or such third party technologies become subject to claims directed to or against the third party technologies used by us, or if we experience substantial increases in royalty payments under these third party licenses, our business could be materially and adversely affected.

9

Table of Contents

Employees

As of December 31, 2014, we had a total of 183 employees within the following departments: 110 in engineering, 37 in sales and marketing, 16 in operations and customer support and 20 in management and administration. We are not subject to any collective bargaining agreement and we believe that our relationships with our employees are good.

Item 1A. RISK FACTORS

Our future operating results are highly uncertain. Before deciding to invest in our common stock or to maintain or increase your investment, you should carefully consider the risks described below, in addition to the other information contained in this report and in our other filings with the SEC, including our reports on Forms 10-K, 10-Q and 8-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. If any of these risks actually occur, that could seriously harm our business, financial condition or results of operations. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

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

In our Wireless business segment, we sell primarily to large carriers, cable operators, 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, 2014, sales to Sprint and their affiliates comprised 68.0% of our total revenues. Because of our customer concentration, this carrier 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, cable operators, 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, Softbank and Sprint Nextel completed a merger 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 also derive a significant portion of our revenues from a few vertical markets, such as wireless carriers, cable operators, and handset manufacturers. In order to sustain and grow our business, we must continue to sell our software products into these vertical markets. Shifts in the dynamics of these vertical markets, such as new product introductions by our competitors, could materially harm our results of operations, financial condition and prospects. To increase our sales outside our core vertical markets, for example to large enterprises, requires us to devote time and resources to hire and train sales employees familiar with those industries. Even if we are successful in hiring and training sales teams, customers in other vertical markets may not need or sufficiently value our current products or new product introductions.

In 2014, we 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 May 6, 2014, the Board of Directors approved a plan of restructuring intended to streamline and flatten the Company s organization, reduce overall headcount by approximately 20% and reduce its overall cost

structure by approximately $2.0 million per quarter. This resulted in a special one-time restructuring charge of $1.8 million that was recorded in the fiscal quarter ended June 30, 2014. At the same time, we increased our 2013 restructuring reserve by $0.6 million to update and adjust our lease termination cost assumptions. 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.

If we fail to meet the requirements for continued listing on the NASDAQ Global Select Market, our common stock would likely be delisted from trading on the NASDAQ Global Select Market, which could adversely affect the liquidity of our common stock and cause our trading price to decline.

Our common stock is currently listed for quotation on the NASDAQ Global Select Market. We are required to meet specified financial requirements in order to maintain our listing on the NASDAQ Global Select Market. If we fail to satisfy the NASDAQ Global Select Market s continued listing requirements, our common stock would likely be delisted from the NASDAQ Global Select Market, in which case our common stock may trade on the OTC Bulletin Board. Any potential delisting of our common stock from the NASDAQ Global Select Market would likely result in decreased liquidity and increased volatility of our common stock, and would likely cause our trading price to decline.

During 2014, the Company no longer met the requirement of NASDAQ Rule 5450(b)(1)(A), which requires companies listed on the NASDAQ Global Select Market to maintain a minimum of $10,000,000 in stockholders equity for continued listing (the Minimum Stockholders Equity Rule). As a result of the proceeds from the Company s private placement stock offering, the Company regained compliance with the Minimum Stockholders Equity Rule. Also in 2014, the Company failed to comply with Nasdaq s Marketplace Rule 5450(a)(1) because the bid price for the Company s common stock over a 30 consecutive business day period had closed below the minimum $1.00 per share requirement for continued listing. The Company regained compliance in January 2015 after the stock price closed above $1.00 per share for 10 consecutive business days.

There can be no assurance that the Company will in the future maintain compliance with the Minimum Stockholders Equity Rule, the minimum $1.00 per share rule, or other requirements for continued listing on NASDAQ.

Our quarterly revenues and operating results are difficult to predict and could fall below analyst or investor expectations, which could cause the price of our common stock to fall.

Our quarterly revenues and operating results have fluctuated significantly in the past and may continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. If our operating results do not meet the expectations of securities analysts or investors, our stock price may decline. Fluctuations in our operating results may be due to a number of factors, including the following:

- the gain or loss of a key customer;
- the size and timing of orders from and shipments to our major customers;
- the size and timing of any product return requests;

our ability to maintain or increase gross margins;

variations in our sales channels or the mix of our product sales;

our ability to anticipate market needs and to identify, develop, complete, introduce, market and produce new products and technologies in a timely manner to address those needs;

the availability and pricing of competing products and technologies and the resulting effect on sales and pricing of our products;

acquisitions;

- the effect of new and emerging technologies;
- the timing of acceptance of new mobile services by users of our customers services;
- deferrals of orders by our customers in anticipation of new products, applications, product enhancements or operating systems; and
- general economic and market conditions.

We have difficulty predicting the volume and timing of orders. In any given quarter, our sales have involved, and we expect will continue to involve, large financial commitments from a relatively small number of customers. As a result, the cancellation or deferral of even a small number of orders would reduce our revenues, which would adversely affect our quarterly financial performance. Also, we have often recorded a large amount of our sales in the last month of the quarter and often in the last week of that month. Accordingly, delays in the closing of sales near the end of a quarter could cause quarterly revenues to fall substantially short of anticipated levels. Significant sales may also occur earlier than expected, which could cause operating results for later quarters to compare unfavorably with operating results from earlier quarters.

Future orders may come from new customers, or from existing customers for new products. The sales cycles may be greater than what we have experienced in the past, increasing the difficulty to predict quarterly revenues.

Because we sell primarily to large carriers and OEM customers, we have no direct relationship with most end-users of our products. This indirect relationship delays feedback and blurs signals of change in the quick-to-evolve wireless ecosystem, and is one of the reasons we have difficulty predicting demand.

A large portion of our operating expenses, including rent, depreciation and amortization, is fixed and difficult to reduce or change. Accordingly, if our total revenue does not meet our expectations, we may not be able to adjust our expenses quickly enough to compensate for the shortfall in revenue. In that event, our business, financial condition and results of operations would be materially and adversely affected.

Due to all of the foregoing factors, and the other risks discussed in this report, you should not rely on quarter-to-quarter comparisons of our operating results as an indication of future performance.

Technology and customer needs change rapidly in our market, which could render our products obsolete and negatively affect our business, financial condition and results of operations.

Our success depends on our ability to anticipate and adapt to changes in technology and industry standards. We will also need to continue to develop and introduce new and enhanced products to meet our target markets changing demands, keep up with evolving industry standards, including changes in the Microsoft, Google and Apple operating systems with which our products are designed to be compatible, and to promote those products successfully. The communications and utilities software markets in which we operate are characterized by rapid technological change, changing customer needs, frequent new product introductions, evolving industry standards and short product life cycles. In addition, the technology we market, which has been sold as software in the past, can be integrated at the chipset level by the leading mobile chipset manufacturers. Any of these factors could render our existing products obsolete and unmarketable. In addition, new products and product enhancements can require long development and testing periods as a result of the complexities inherent in today s computing environments and the performance

demanded by customers and called for by evolving wireless networking technologies. If our target markets do not develop as we anticipate, our products do not gain widespread acceptance in these markets, or we are unable to develop new versions of our software products that can operate on future wireless networks and PC and mobile device operating systems and interoperate with other popular applications, our business, financial condition and results of operations could be materially and adversely affected.

Table of Contents

Competition within our target markets is intense and includes numerous established competitors and new entrants, which could negatively affect our revenues and results of operations.

We operate in markets that are extremely competitive and subject to rapid changes in technology. Because there are low barriers to entry into the software markets in which we participate and may participate in the future, we expect significant competition to continue from both established and emerging software companies in the future, both domestic and international. In fact, our growth opportunities in new product markets could be limited to the extent established and emerging software companies enter or have entered those markets. Furthermore, our existing and potential OEM customers may acquire or develop products that compete directly with our products.

Many of our other current and prospective competitors have significantly greater financial, marketing, service, support, technical and other resources than we do. As a result, they may be able to adapt more quickly than we can to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products. Announcements of competing products by competitors could result in the cancellation of orders by customers in anticipation of the introduction of such new products. In addition, some of our competitors are currently making complementary products that are sold separately. Such competitors could decide to enhance their competitive position by bundling their products to attract customers seeking integrated, cost-effective software applications. Some competitors have a retail emphasis and offer OEM products with a reduced set of features. The opportunity for retail upgrade sales may induce these and other competitors to make OEM products available at their own cost or even at a loss. We also expect competition to increase as a result of software industry consolidations, which may lead to the creation of additional large and well-financed competitors. Increased competition is likely to result in price reductions, fewer customer orders, reduced margins and loss of market share.

We are entering new, emerging markets in which we have limited experience; if these markets do not develop or we are unable to otherwise succeed in them, our revenues will suffer and the price of our common stock will likely decline.

Our recent and planned product introductions to support new higher speed networking and 4G technologies have allowed us to enter new markets. A viable market for these products may not develop or be sustainable, and we may face intense competition in these markets. In addition, our success in these markets depends on our carrier and MSO customers ability to successfully introduce new mobile services enabled by our products and our ability to broaden our carrier customer base, which we believe will be difficult and time-consuming. If the expected benefits from entering new markets do not materialize, our revenues will suffer and the price of our common stock would likely decline. In addition, to the extent we enter new markets through acquisitions of companies or technologies, our financial condition could be harmed or our stockholders could suffer dilution without a corresponding benefit to our company if we do not realize expected benefits of entering such new markets.

If the adoption of and investments in new technologies and services grows more slowly than anticipated in our product planning and development, our operating results, financial condition and prospects may be negatively affected.

If the adoption of and investments in new networking and 4G technologies and services does not grow or grows more slowly than anticipated, we will not obtain the anticipated returns from our planning and development investments. We have introduced new high-speed networking and 4G products, but the pace of the market introduction of such technologies is uncertain. Future sales and any future profits from these and related products are substantially dependent upon the acceptance and use of these new technologies, and on the continued adoption and use of mobile data services by end-users.

Many of our customers and other communications service providers have made and continue to make major investments in next generation networks that are intended to support more complex applications. If communications service providers delay their deployment of networks or fail to deploy such networks

13

successfully, demand for our products could decline, which would adversely affect our revenues. Also, to the extent we devote substantial resources and incur significant expenses to enable our products to be interoperable with new networks that have failed or have been delayed or not deployed, our operating results, financial condition and prospects may be negatively affected.

If we are unable to retain key personnel, the loss of their services could materially and adversely affect our business, financial condition and results of operations.

Our future performance depends in significant part upon the continued service of our senior management and other key technical and consulting personnel. We do not have employment agreements with our key employees that govern the length of their service. The loss of the services of our key employees would materially and adversely affect our business, financial condition and results of operations. Our future success also depends on our ability to continue to attract, retain and motivate qualified personnel, particularly highly skilled engineers involved in the ongoing research and development required to develop and enhance our products. Competition for these employees remains high and employee retention is a common problem in our industry. Our inability to attract and retain the highly trained technical personnel that are essential to our product development, marketing, service and support teams may limit the rate at which we can generate revenue, develop new products or product enhancements and generally would have an adverse effect on our business, financial condition and results of operations.

We rely directly and indirectly on third-party intellectual property and licenses, which may not be available on commercially reasonable terms or at all.

Many of the Company s products and services include third-party intellectual property, which requires licenses from those third parties directly to us or to unrelated companies which provide us with sublicenses and/or execution of services for the operation of our business. These products and services include our wireless suite of products as well as our productivity and graphics products. The Company has historically been able to obtain such licenses on reasonable terms. There is however no assurance that in the future the necessary licenses could be obtained on acceptable terms or at all. If the Company or our third party service providers are unable to obtain or renew critical licenses on reasonable terms, we may be forced to terminate or curtail our products and services which rely on such intellectual property and our financial condition and operating results may be materially adversely affected.

If we fail to continue to establish and maintain strategic relationships with mobile device manufacturers, wireless carriers and network infrastructure manufacturers, market acceptance of our products and our profitability may suffer.

Most of our strategic relationships with mobile device manufacturers are not subject to written contract, but rather are in the form of informal working relationships. We believe these relationships are valuable to our success. In particular, these relationships provide us with insights into product development and emerging technologies, which allows us to keep abreast of, or anticipate, market trends and helps us serve our current and prospective customers. Because these relationships are not typically governed by written agreements, there is no obligation for many of our partners to continue working with us. If we are unable to maintain our existing strategic relationships with mobile device manufacturers or if we fail to enter into additional strategic relationships or the parties with whom we have strategic relationships favor one of our competitors, our ability to provide products that meet our current and prospective customers needs could be compromised and our reputation and future revenue prospects could suffer. For example, if our software does not function well with a popular mobile device because we have not maintained a relationship with its manufacturer, carriers seeking to provide that device to their respective customers could choose a competitor s software over ours or develop their own. Even if we succeed in establishing these relationships, they may not result in additional customers or revenues.

Table of Contents

Our growth depends in part on our customers ability and willingness to promote services and attract and retain new customers or achieve other goals outside of our control.

We sell our products for use on handheld devices primarily through our carrier customers. Losing the support of these customers may limit our ability to compete in existing and potential markets and could negatively affect our revenues. In addition, the success of these customers and their ability and willingness to market services supported by our products is critical to our future success. Our ability to generate revenues from sales of our software is also constrained by our carrier customers ability to attract and retain customers. We have no input into or influence upon their marketing efforts and sales and customer retention activities. If our large carrier customers fail to maintain or grow demand for their services, revenues or revenue growth from our products designed for use on mobile devices will decline and our results of operations will suffer.

Acquisitions of companies or technologies may disrupt our business and divert management attention and cause our current operations to suffer.

We have historically made targeted acquisitions of smaller companies with important technology and expect to continue to do so in the future. As part of any acquisition, we will be required to assimilate the operations, products and personnel of the acquired businesses and train, retain and motivate key personnel from the acquired businesses. We may not be able to maintain uniform standards, controls, procedures and policies if we fail in these efforts. Similarly, acquisitions may cause disruptions in our operations and divert management s attention from our company s day-to-day operations, which could impair our relationships with our current employees, customers and strategic partners. Acquisitions may also subject us to liabilities and risks that are not known or identifiable at the time of the acquisition.

We may also have to incur debt or issue equity securities in order to finance future acquisitions. Our financial condition could be harmed to the extent we incur substantial debt or use significant amounts of our cash resources in acquisitions. The issuance of equity securities for any acquisition could be substantially dilutive to our existing stockholders. In addition, we expect our profitability could be adversely affected because of acquisition-related accounting costs, write offs, amortization expenses, and charges related to acquired intangible assets. In consummating acquisitions, we are also subject to risks of entering geographic and business markets in which we have had limited or no prior experience. If we are unable to fully integrate acquired businesses, products or technologies within existing operations, we may not receive the intended benefits of acquisitions.

Our operating income or loss may continue to change due to shifts in our sales mix and increased spending on our research and development.

Our operating income or loss can change quarter to quarter and year to year due to a change in our sales mix and the timing of our continued investments in research and development and infrastructure. We continue to invest in research and development which is the lifeline of our technology portfolio. The timing of these additional expenses can vary significantly quarter to quarter and even from year to year.

Our products may contain undetected software defects, which could negatively affect our revenues.

Our software products are complex and may contain undetected defects. In the past, we have discovered software defects in certain of our products and have experienced delayed or lost revenues during the period it took to correct these problems. Although we and our OEM customers test our products, it is possible that errors may be found or occur in our new or existing products after we have commenced commercial shipment of those products. Defects, whether actual or perceived, could result in adverse publicity, loss of revenues, product returns, a delay in market

acceptance of our products, loss of competitive position or claims against us by customers. Any such problems could be costly to remedy and could cause interruptions, delays, or cessation of our product sales, which could cause us to lose existing or prospective customers and could negatively affect our results of operations. In addition, some of our software contains open source components that are licensed under the GNU General Public License and similar open source

licenses. These components may contain undetected defects or incompatibilities, may cause us to lose control over the development of portions of our software code, and may expose us to claims of infringement if these components are, or incorporate, infringing materials, the licenses are not enforceable or are modified to become incompatible with other open source licenses, or exposure to misappropriation claims if these components include unauthorized materials from a third party.

Regulations affecting our customers and us and future regulations, to which they or we may become subject to, may harm our business.

Certain of our customers in the communications industry are subject to regulation by the Federal Communications Commission, which could have an indirect effect on our business. In addition, the United States telecommunications industry has been subject to continuing deregulation since 1984. We cannot predict when, or upon what terms and conditions, further regulation or deregulation might occur or the effect regulation or deregulation may have on demand for our products from customers in the communications industry. Demand for our products may be indirectly affected by regulations imposed upon potential users of those products, which may increase our costs and expenses.

We may be unable to adequately protect our intellectual property and other proprietary rights, which could negatively impact our revenues.

Our success is dependent upon our software code base, our programming methodologies and other intellectual properties and proprietary rights. In order to protect our proprietary technology, we rely on a combination of trade secrets, nondisclosure agreements, patents, and copyright and trademark law. We currently own U.S. trademark registrations for certain of our trademarks and U.S. patents for certain of our technologies. However, these measures afford us only limited protection. Furthermore, we rely primarily on shrink wrap licenses that are not signed by the end user and, therefore, may be unenforceable under the laws of certain jurisdictions. Accordingly, it is possible that third parties may copy or otherwise obtain our rights without our authorization. It is also possible that third parties may independently develop technologies similar to ours. It may be difficult for us to detect unauthorized use of our intellectual property and proprietary rights.

We may be subject to claims of intellectual property infringement as the number of trademarks, patents, copyrights and other intellectual property rights asserted by companies in our industry grows and the coverage of these patents and other rights and the functionality of software products increasingly overlap. From time to time, we have received communications from third parties asserting that our trade name or features, content, or trademarks of certain of our products infringe upon intellectual property rights held by such third parties. We have also received correspondence from third parties separately asserting that our products may infringe on certain patents held by each of the parties. Although we are not aware that any of our products infringe on the proprietary rights of others, third parties may claim infringement by us with respect to our current or future products. Additionally, our customer agreements require that we indemnify our customers for infringement claims made by third parties involving our intellectual property embedded in their products. Infringement claims, whether with or without merit, could result in time-consuming and costly litigation, divert the attention of our management, cause product shipment delays or require us to enter into royalty or licensing agreements with third parties. If we are required to enter into royalty or licensing agreements, they may not be on terms that are acceptable to us. Unfavorable royalty or licensing agreements could seriously impair our ability to market our products.

We may raise additional capital through the issuance of additional equity or convertible debt securities or by borrowing money, in order to meet our capital needs. Additional funds may not be available on terms acceptable to us to allow us to meet our capital needs.

We believe that the cash and cash equivalents and short-term investments on hand and the cash we expect to generate from operations will be sufficient to meet our capital needs for at least the next twelve months. However, it is possible that we may need or choose to obtain additional financing to fund our activities in the future. We could raise these funds by selling more stock to the public or to selected investors, or by borrowing money. We may not be able to obtain additional funds on favorable terms, or at all. If adequate

funds are not available, we may be required to curtail our operations or other business activities significantly or to obtain funds through arrangements with strategic partners or others that may require us to relinquish rights to certain technologies or potential markets.

In addition, we may file with the SEC a shelf registration statement to sell from time to time additional shares of our common stock in one or more offerings in amounts, at prices and on the terms that we will determine at the time of offering. If we raise additional funds by issuing additional equity or convertible debt securities (whether in a public offering or private placement), the ownership percentages of existing stockholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock. We currently have no established line of credit or other business borrowing facility in place.

It is possible that our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will depend on many factors, including:

- the market acceptance of our products;
- the levels of promotion and advertising that will be required to launch our products and achieve and maintain a competitive position in the marketplace;
- our business, product, capital expenditure and research and development plans and product and technology roadmaps;
- the levels of working capital that we maintain;
- capital improvements to new and existing facilities;
- our ability to meet our headcount hiring commitment to the state of Pennsylvania;
- technological advances;
- our competitors response to our products; and
- our relationships with suppliers and customers.

In addition, we may raise additional capital to accommodate planned growth, hiring and infrastructure needs or to consummate acquisitions of other businesses, products or technologies.

Our business, financial condition and operating results could be adversely affected as a result of legal, business and economic risks specific to international operations.

In recent years, our revenues derived from sales to customers outside the U.S. have not been material. Our revenues derived from such sales can vary from quarter to quarter and from year to year. We also frequently ship products to our domestic customers international manufacturing divisions and subcontractors. In the future, we may expand these international business activities. International operations are subject to many inherent risks, including:

- general political, social and economic instability;
- trade restrictions;
- the imposition of governmental controls;
- exposure to different legal standards, particularly with respect to intellectual property;
- burdens of complying with a variety of foreign laws;
- import and export license requirements and restrictions of the United States and any other country in which we operate;
- unexpected changes in regulatory requirements;
- foreign technical standards;
- changes in tariffs;
- difficulties in staffing and managing international operations;

- difficulties in securing and servicing international customers;
- difficulties in collecting receivables from foreign entities;
- fluctuations in currency exchange rates and any imposition of currency exchange controls; and
- potentially adverse tax consequences.

These conditions may increase our cost of doing business. Moreover, as our customers are adversely affected by these conditions, our business with them may be disrupted and our results of operations could be adversely affected.

Security and privacy breaches may harm our business.

The uninterrupted operation of our hosted solutions and the confidentiality and security of third-party information is critical to our business. Any failures in our security and privacy measures, such as hacking of our systems by outsiders, could have a material adverse effect on our financial position and results of operations. If we are unable to protect, or our customers perceive that we are unable to protect, the security and privacy of our electronic information, our growth could be materially adversely affected. A security or privacy breach may:

- cause our customers to lose confidence in our solutions;
- harm our reputation;
- expose us to liability; and
- increase our expense from potential remediation costs.

While we believe we use proven applications designed for data security and integrity to process electronic transactions, there can be no assurance that our use of these applications will be sufficient to address changing market conditions or the security and privacy concerns of existing and potential customers. In addition, our customers and end users may use our products and services in a manner which violates security or data privacy laws in one or more jurisdictions. Any significant or high profile data privacy breaches or violations of data privacy laws, whether directly through our hosted solutions or by third parties using our products and services, could result in the loss of business and reputation, litigation against us and regulatory investigations and penalties that could adversely affect our operating results and financial condition.

Interruptions or delays in service from data center hosting facilities could impair the delivery of our service and harm our business.

We currently serve our customers from data center hosting facilities. Any damage to, or failure of, our systems generally could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their on-demand services and adversely affect our renewal

rates and our ability to attract new customers.

We may have exposure to additional tax liabilities.

As a multinational corporation, we are subject to income taxes as well as sales, use and other non-income based taxes, in both the United States and various foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes, sales and use taxes, and other tax liabilities. Changes in tax laws or tax rulings may have a significantly adverse impact on our effective tax rate.

We are also subject to non-income based taxes, such as payroll, sales, use, value-added, net worth, property and goods and services taxes, in both the United States and various foreign jurisdictions. We are regularly under audit by tax authorities with respect to these non-income based taxes and may have exposure to additional non-income based tax liabilities. An increasing number of states have considered or adopted laws that attempt to impose obligations on out-of-state retailers to collect sales and use taxes on their behalf. A successful assertion by one or more states or foreign countries requiring us to collect sales and use taxes where we do not do so could result in substantial tax liabilities, including for past sales, as well as penalties and interest.

Table of Contents

Although we believe that our income and non-income based tax estimates are reasonable, there is no assurance that our provisions for taxes are correct, or that the final determination of tax audits or tax disputes will not be different from what is reflected in our historical income tax provisions and accruals. If we are required to pay substantially more taxes in the future or for prior periods, our operating results and financial condition could be adversely affected

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

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 33,600 square feet of space pursuant to lease that expires on May 31, 2016. 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. Internationally, we lease space in Belgrade, Serbia that expires December 30, 2016.

We lease an additional 19,100 square feet in Aliso Viejo, California under a lease that expires January 31, 2022. In August 2014, we signed an addendum to sublease all of the space commencing on September 15, 2014 for a three year period, with two, two-year renewal options. The remaining lease expense, net of sublease income, has been accrued for in our 2013 restructuring liability account.

We lease approximately 15,300 square feet in Watsonville, California under a lease that expires September 30, 2018. In March 2014, we signed an addendum to sublease all of the space commencing on May 1, 2014. We continued to pay our current monthly rent through June 30, 2014. Beginning on July 1, 2014, we are paying the landlord a minimum amount of rent, with annual escalations, through the end of the lease. This lease expense has been accrued for in our 2013 restructuring liability account. We have moved into a significantly smaller facility in Santa Cruz, California and are paying month-to-month rent.

Item 3. LEGAL PROCEEDINGS

The Company 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 4. MINE SAFETY DISCLOSURES

Not Applicable.

19

Table of Contents

PART II

Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Our common stock is traded on the NASDAQ Global Market under the symbol SMSI. The high and low sale prices for our common stock as reported by NASDAQ are set forth below for the periods indicated.

	High	Low
YEAR ENDED DECEMBER 31, 2014:		
First Quarter	$ 2.69	$ 1.44
Second Quarter	2.07	0.66
Third Quarter	1.37	0.88
Fourth Quarter	1.23	0.74
YEAR ENDED DECEMBER 31, 2013:		
First Quarter	$ 1.78	$ 1.26
Second Quarter	1.49	1.06
Third Quarter	1.31	0.88
Fourth Quarter	1.57	0.79

On February 20, 2015, the closing sale price for our common stock as reported by NASDAQ was $1.46.

For information regarding Securities Authorized for Issuance under Equity Compensation Plans, please refer to Item 12.

Stock Performance Graph

The following graph and information compares the cumulative total stockholder return on our common stock against the cumulative total return of the S&P Midcap 400 Index and the S&P Midcap Applications Software Index (Peer Group) for the same period.

The graph covers the period from December 31, 2009 through December 31, 2014. The graph assumes that $100 was invested in our common stock on December 31, 2009, and in each index, and that all dividends were reinvested. No cash dividends have been declared on our common stock. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.

Table of Contents

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Smith Micro Software, Inc., the S&P Midcap 400 Index, and S&P MidCap Application Software

* $100 invested on 12/31/09 in stock or index, including reinvestment of dividends. Fiscal year ending December 31.

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	12/09	12/10	12/11	12/12	12/13	12/14
Smith Micro Software, Inc.	100.00	172.02	12.35	16.39	16.17	10.60
S&P Midcap 400	100.00	126.64	124.45	146.69	195.84	214.97
S&P MidCap Application Software	100.00	132.83	139.38	167.35	220.04	227.94

Holders

As of February 20, 2015, there were approximately 181 holders of record of our common stock based on information provided by our transfer agent.

Dividends

We have never paid any cash dividends on our common stock and we have no current plans to do so.

Table of Contents

Recent Sales of Unregistered Securities

On August 15, 2014, the Company entered into a common stock purchase agreement with a number of accredited investors pursuant to which the Company issued and sold 6,845,830 shares of its common stock at a price per share of $0.816 in a private placement. The transaction closed on August 20, 2014 and the Company realized gross proceeds of $5.6 million before deducting commissions and other expenses. Offering costs related to the transaction totaled $0.4 million, comprised of $0.2 million of commissions and $0.2 million of legal and other expenses, resulting in net proceeds of $5.2 million. The offer and sale of the shares of Common Stock in the private placement was exempt from registration pursuant to Section 4(2) of and Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended.

Purchases of Equity Securities by the Company

The table set forth below shows all purchases of securities by us during the fiscal year 2014:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Mar. 1-31. 2014	15,735	$ 1.63		
Jun. 1-30, 2014	157,919	$ 1.61		
Sep. 1-30, 2014	50,767	$ 0.97		
Dec. 1-31, 2014	67,202	$ 0.93		
Total	291,623(a)			

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 291,623 shares during the periods set forth in the table. All of the shares were cancelled when they were acquired.

Table of Contents

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes thereto appearing elsewhere in this Annual Report. The following selected consolidated statement of comprehensive income (loss) data for the years ended December 31, 2014, 2013 and 2012, and the consolidated balance sheet data at December 31, 2014 and 2013, have been derived from audited consolidated financial statements included elsewhere in this Annual Report. The consolidated statement of comprehensive income (loss) data presented below for the years ended December 31, 2011 and 2010, and the consolidated balance sheet data at December 31, 2012, 2011 and 2010 are derived from audited consolidated financial statements that are not included in this Annual Report.

	Year Ended December 31,				
	2014	**2013**	**2012**	**2011**	**2010**
Consolidated Statement of Comprehensive Income (Loss) Data (in thousands, except per share data):					
Revenues	$ 36,979	$ 42,675	$ 43,329	$ 57,767	$ 130,501
Cost of revenues	9,317	9,707	8,448	13,761	15,507
Gross profit	27,662	32,968	34,881	44,006	114,994
Operating expenses:					
Selling and marketing	9,559	15,675	16,666	26,594	29,708
Research and development	14,192	21,305	24,767	41,711	42,759
General and administrative	13,218	18,216	20,211	25,279	24,146
Restructuring expenses	2,435	5,602	238	3,184	
Goodwill and long-lived asset impairment				112,904	
Total operating expenses	39,404	60,798	61,882	209,672	96,613
Operating income (loss)	(11,742)	(27,830)	(27,001)	(165,666)	18,381
Non-operating income:					
Change in fair value of contingent liabiltiy			1,210		
Interest and other income (expense), net	(8)	30	94	131	130
Income (loss) before provision for income taxes	(11,750)	(27,800)	(25,697)	(165,535)	18,511
Provision for income tax expense (benefit)	49	153	(234)	(5,929)	6,165
Net income (loss)	(11,799)	(27,953)	(25,463)	(159,606)	12,346
Other comprehensive income (loss), before tax:					
Unrealized holding gains (losses) on available- for-sale securities		7	33	(24)	(14)
Income tax expense (benefit) related to items of other comprehensive income (expense)			6	1	(6)
Other comprehensive income (expense), net of tax		7	27	(25)	(8)
Comprehensive income (loss)	$ (11,799)	$ (27,946)	$ (25,436)	$ (159,631)	$ 12,338

Net income (loss) per share:					
Basic	$ (0.29)	$ (0.76)	$ (0.71)	$ (4.48)	$ 0.36
Diluted	$ (0.29)	$ (0.76)	$ (0.71)	$ (4.48)	$ 0.36
Weighted average shares:					
Basic	40,649	36,982	35,849	35,617	34,204
Diluted	40,649	36,982	35,849	35,617	34,615

	As of December 31,				
	2014	2013	2012	2011	2010
Consolidated Balance Sheet Data (in thousands):					
Total assets	$ 27,390	$ 31,538	$ 54,395	$ 79,941	$ 234,892
Total liabilities	12,488	13,367	11,733	15,081	16,627
Accumulated comprehensive (deficit) earnings	(208,284)	(196,485)	(168,539)	(143,103)	16,528
Total stockholders equity	$ 14,902	$ 18,171	$ 42,662	$ 64,860	$ 218,265

Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Annual Report. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation the disclosures made in Item 1A of Part I of this Annual Report under the caption Risk Factors.

Risk factors that could cause actual results to differ from those contained in the forward-looking statements include but are not limited to: our dependence upon the large carrier customers for a significant portion of our revenues; deriving revenues from a small number of customers and products; being delisted from the NASDAQ; changes in demand for our products; our failure to successfully compete; changes in technology; our entry into new markets; failure of our customers to adopt new technologies; loss of key personnel; the availability of third party intellectual property and licenses; failure to maintain strategic relationships with our customers; potential fluctuations in quarterly results; our failure to protect intellectual property; exposure to intellectual property claims; our inability to raise more funds to meet our capital needs; undetected software defects; security and privacy breaches in our systems or interruptions or delays in the services we provide which could damage client relations; and doing business internationally.

Introduction and Overview

Smith Micro provides software solutions to simplify and enhance the mobile experience. As a leader in wireless connectivity, our applications ensure the best Quality of Experience for mobile users while optimizing networks for wireless service providers and enterprises. Using our intelligent policy-on-device platform, along with premium voice, video and content monetization services, we create new opportunities to engage consumers and capitalize on the growth of connected devices. In addition to wireless and mobility software, Smith Micro develops and distributes personal, professional and educational productivity and graphics products and tools for consumers, artists, animators and designers worldwide.

Over the past three decades, the Company has developed deep expertise in embedded software for networked devices, policy-based management platforms, and highly-scalable mobile applications and hosted services. For organizations struggling to reduce costs and complexity in the fragmented, rapidly evolving mobile market, Smith Micro offers proven solutions that increase reliability and efficiency while accelerating delivery and value of mobile services to consumers.

For the year ended December 31, 2014, revenues to one customer and their respective affiliates in the Wireless business segment accounted for 68.0% of the Company s total revenues, and one customer in the Productivity & Graphics business segment accounted for 11.2% of the Company s total revenues. These two customers accounted for 87% of accounts receivable for the year ended December 31, 2014. For the year ended December 31, 2013, revenues

to two customers and their respective affiliates in the Wireless business segment accounted for 53.1% and 13.0% of the Company s total revenues, and one customer in the Productivity & Graphics business segment accounted for 11.4% of the Company s total revenues. These three customers accounted for 83% of accounts receivable for the year ended December 31, 2013.

Table of Contents

For the year ended December 31, 2012, revenues to two customers and their respective affiliates in the Wireless business segment accounted for 40.7% and 20.5% of the Company s total revenues and 78% of accounts receivable.

Results of Operations

The following table sets forth certain consolidated statement of comprehensive income (loss) data as a percentage of total revenues for the periods indicated:

	Year Ended December 31,		
	2014	**2013**	**2012**
Revenues	100.0 %	100.0 %	100.0 %
Cost of revenues	25.2	22.7	19.5
Gross profit	74.8	77.3	80.5
Operating expenses:			
Selling and marketing	25.9	36.7	38.5
Research and development	38.4	49.9	57.2
General and administrative	35.7	42.7	46.6
Restructuring expenses	6.6	13.2	0.5
Total operating expenses	106.6	142.5	142.8
Operating loss	(31.8)	(65.2)	(62.3)
Non-operating income:			
Change in fair value of contigent liability			2.8
Interest and other income (expense), net		0.1	0.2
Loss before provision for income taxes	(31.8)	(65.1)	(59.3)
Provision for income tax expense (benefit)	0.1	0.4	(0.5)
Net loss	(31.9)%	(65.5)%	(58.8)%

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, NetWise and CommSuite family of products; and
- Productivity & Graphics, which includes our consumer-based products: Poser, Anime Studio, Manga Studio, MotionArtist and StuffIt.

Table of Contents

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

	Year Ended December 31,		
	2014	2013	2012
Wireless	$ 31,276	$ 35,853	$ 37,154
Productivity & Graphics	5,703	6,822	6,175
Total revenues	36,979	42,675	43,329
Cost of revenues	9,317	9,707	8,448
Gross profit	$ 27,662	$ 32,968	$ 34,881

Cost of revenues. Cost of revenues consists of direct product and assembly, maintenance, and royalty costs.

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

Change in fair value of contingent liability. This is the return-to-profit of a milestone payment accrual that we did not have to pay.

Interest and other income (expense), net. Interest and other income are 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. Interest and other expense are primarily related to the credit-adjusted risk-free interest rate used to measure our operating lease termination liabilities in restructuring.

Provision for income tax expense (benefit). 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. After consideration of the Company s continuing cumulative loss position as of December 31, 2014, the Company retained a valuation allowance related to its U.S.-based deferred tax assets of $75.7 million at December 31, 2014. During fiscal years 2014, 2013 and 2012, the valuation allowance on deferred tax assets increased by $3.2 million, $12.1 million and $7.2 million, respectively.

Table of Contents

Year Ended December 31, 2014 Compared to the Year Ended December 31, 2013

Revenues. Revenues of $37.0 million for fiscal year 2014 decreased $5.7 million, or 13.3%, from $42.7 million for fiscal year 2013. Wireless revenues of $31.3 million decreased $4.6 million, or 12.8%, primarily due to lower sales of our legacy connection manager products of $7.6 million partially offset by higher sales of our CommSuite products of $3.0 million. Productivity & Graphics sales decreased $1.1 million, or 16.4%, primarily due to lower customer demand and fewer new releases this year as we shift our future focus from consumers to new professional markets such as gaming and industrial design. While we have launched new wireless products, 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 of $9.3 million for fiscal year 2014 decreased $0.4 million, or 4.0%, from $9.7 million for fiscal year 2013. Cost reduction savings as a result of our restructuring of $1.2 million was partially offset by increased royalties of $0.4 million due to product mix and $0.4 million of maintenance costs associated with new product releases.

Gross profit. Gross profit of $27.7 million or 74.8% of revenues for fiscal year 2014 decreased $5.3 million, or 16.1%, from $33.0 million, or 77.3% of revenues for fiscal year 2013. The 2.5 percentage point decrease was primarily due to the lower revenues.

Selling and marketing. Selling and marketing expenses of $9.6 million for fiscal year 2014 decreased $6.1 million, or 39.0%, from $15.7 million for fiscal year 2013. This decrease was primarily due cost reduction savings as a result of our restructuring; headcount reductions of $4.4 million and travel and other cost reductions of $1.2 million. Stock-based compensation decreased from $0.8 million to $0.3 million, or $0.5 million.

Research and development. Research and development expenses of $14.2 million for fiscal year 2014 decreased $7.1 million, or 33.4%, from $21.3 million for fiscal year 2013. Lower headcount accounted for the decrease of $6.9 million primarily due to our restructuring. Stock-based compensation decreased from $0.9 million to $0.7 million, or $0.2 million.

General and administrative. General and administrative expenses of $13.2 million for fiscal year 2014 decreased $5.0 million, or 27.4%, from $18.2 million for fiscal year 2013. This decrease was primarily due to lower space and occupancy costs as a result of our restructuring of $1.7 million, headcount and other cost reductions as a result of our restructuring of $1.3 million, lower depreciation of $1.0 million, and lower legal and accounting fees of $0.4 million. Stock-based compensation expense decreased from $2.1 million to $1.5 million, or $0.6 million.

Restructuring expenses. Restructuring expense was $2.4 million for fiscal year 2014 due to one-time employee terminations of $1.3 million of non-cash stock-based compensation and $0.4 million of severance costs, $0.6 million for lease terminations, and $0.1 million of other related expenses. Restructuring expenses were $5.6 million for fiscal year 2013. These charges were for lease/rental terminations of $3.2 million, severance costs for affected employees of $1.2 million, fixed asset write-offs as a result of our lease/rental terminations of $1.0 million and other related costs of $0.2 million.

Interest and other income (expense), net. Interest and other income (expense), net was de minimis for both fiscal years 2014 and 2013.

Provision for income tax expense (benefit). We recorded income tax expense of $49,000 and $153,000 for fiscal years 2014 and 2013, respectively, primarily related to foreign income taxes.

Table of Contents

Year Ended December 31, 2013 Compared to the Year Ended December 31, 2012

Revenues. Revenues of $42.7 million for fiscal year 2013 decreased $0.6 million, or 1.5%, from $43.3 million for fiscal year 2012. Wireless revenues of $35.9 million decreased $1.3 million, or 3.5%, primarily due to lower sales of our legacy connection manager products of $5.2 million partially offset by higher sales of our CommSuite products of $3.2 million and NetWise products of $0.7 million. Productivity & Graphics sales increased $0.7 million, or 10.5%, primarily due to increases in our core product lines of Poser 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 legacy 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 of $9.7 million for fiscal year 2013 increased $1.3 million, or 14.9%, from $8.4 million for fiscal year 2012. The increase was primarily due to the product mix in Wireless of $1.1 million and product mix in Productivity & Graphics of $0.2 million.

Gross profit. Gross profit of $33.0 million or 77.3% of revenues for fiscal year 2013 decreased $1.9 million, or 5.5%, from $34.9 million, or 80.5% of revenues for fiscal year 2012. The 3.2 percentage point decrease was primarily due to the lower revenues and product mix.

Selling and marketing. Selling and marketing expenses of $15.7 million for fiscal year 2013 decreased $1.0 million, or 5.9%, from $16.7 million for fiscal year 2012. This decrease was primarily due to lower personnel related expenses and severance of $0.4 million and lower travel and trade shows of $0.5 million. Stock-based compensation decreased from $0.9 million to $0.8 million, or $0.1 million.

Research and development. Research and development expenses of $21.3 million for fiscal year 2013 decreased $3.5 million, or 14.0%, from $24.8 million for fiscal year 2012. This decrease was primarily due to lower headcount. Stock-based compensation increased from $0.8 million to $0.9 million, or $0.1 million due to stock options being issued to many of the engineers late in fiscal year 2012.

General and administrative. General and administrative expenses of $18.2 million for fiscal year 2013 decreased $2.0 million, or 9.9%, from $20.2 million for fiscal year 2012. This decrease was primarily due to lower space and occupancy costs as a result of our restructuring of $1.3 million and lower legal and accounting fees of $0.6 million partially offset by increased travel and other expenses of $0.2 million. Stock-based compensation expense decreased from $2.4 million to $2.1 million, or $0.3 million.

Restructuring expenses. Restructuring expenses of $5.6 million for fiscal year 2013 were related to lease/rental terminations of $3.3 million, severance costs for affected employees of $1.1 million, equipment and improvements write-offs as a result of our lease/rental terminations of $1.0 million and other related costs of $0.2 million. Restructuring expenses of $0.2 million for fiscal year 2012 were related to one-time employee termination and other costs as a result of headcount reductions.

*Change in fair value of contingent liabi*lity. When we acquired Core Mobility in October 2009, we established a pre-acquisition contingency made up of two milestone payments that were part of the purchase price of the business. The first milestone was met and $0.6 million was paid in March 2010. The second milestone was not met and therefore not paid. The Core Mobility shareholders disputed the second milestone in a lawsuit which was found in our favor in August 2012. The plaintiffs chose not to appeal the decision. As a result, we reduced the contingent liability

of $1.2 million to its fair value of $0 at December 31, 2012.

Interest and other income, net. Interest and other income, net was de minimis for fiscal year 2013 and $0.1 million for fiscal year 2012.

Provision for income tax expense (benefit). We recorded income tax expense of $0.2 million for fiscal year 2013 primarily related to foreign income taxes. We recorded an income tax benefit of $0.2 million for fiscal year 2012 related to state R&D tax credits of $0.7 million, partially offset by state and foreign income taxes of $0.5 million.

Liquidity and Capital Resources

At December 31, 2014, we had $13.0 million in cash and cash equivalents and short-term investments and $14.0 million of working capital.

Capital expenditures were $0.2 million for the fiscal year 2014 versus $0.8 million for the fiscal year 2013. The 2014 expenditures were primarily for computer hardware and software.

In August 2014, the Company entered into a common stock purchase agreement (see Note 9) with a number of accredited investors in a private placement pursuant to which the Company agreed to issue and sell to the investors an aggregate of 6,845,830 shares of its common stock at a price per share of $0.816. The transaction closed on August 20, 2014 and the Company realized gross proceeds of $5.6 million before deducting commissions and other expenses of $0.4 million.

In May 2014, the Board approved a restructuring plan (see Note 2) that was implemented during the fiscal quarter ended June 30, 2014 which lowered our overall cost structure by approximately $2.0 million per quarter.

Based on the Company s current financial revenue and profit projections, our reduced cost structure as a result of our 2014 restructuring mentioned above, and the proceeds from the sale of our common stock in a private placement mentioned above, management believes that the Company s existing cash, cash equivalents and short-term investment will be sufficient to fund the its operations through at least the next twelve months.

Operating Activities

In 2014, net cash used in operations was $6.8 million primarily due to our net loss adjusted for depreciation, amortization, non-cash stock-based compensation, inventory and accounts receivable reserves of $4.7 million, decreases in accounts payable and accrued expenses of $2.2 million, and an increase in accounts receivable of $1.0 million. This usage was partially offset by an increase in deferred revenue of $1.0 million and a decrease in prepaid expenses of $0.1 million.

In 2013, net cash used in operations was $16.6 million primarily due to our net loss adjusted for depreciation, amortization, write-off of fixed assets related to our restructuring, non-cash stock-based compensation, inventory and accounts receivable reserves, and other assets of $18.7 million. This usage was partially offset by an increase in accounts payable and accrued liabilities of $1.4 million and a decrease in accounts receivable of $0.7 million.

In 2012, net cash used in operations was $12.8 million primarily due to our net loss adjusted for depreciation, amortization, non-cash stock-based compensation, and inventory and accounts receivable reserves of $17.0 million, a decrease of accounts payable and accrued liabilities of $2.2 million, and an increase in accounts receivable of $1.5 million. This usage was partially offset by a decrease of income taxes receivable of $7.6 million and a decrease in prepaid and other assets of $0.3 million.

Investing Activities

In 2014, cash used by investing activities was de minimis as the sale of short-term investments of $0.2 million was offset by capital expenditures of $0.2 million.

In 2013, cash provided by investing activities of $9.4 million was due to the sale of short-term investments of $10.2 million, partially offset by capital expenditures of $0.8 million.

In 2012, cash provided by investing activities of $24.9 million was due to the sale of short-term investments of $25.2 million, partially offset by capital expenditures of $0.3 million.

Financing Activities

In 2014, cash provided by financing activities was $5.3 million. We received $5.2 million from the sale of our common stock in a private placement. We also received $21,000 from the stock sale for the employee stock purchase plan and $6,000 from the exercise of stock options.

In 2013, cash provided by financing activities was $36,000 as a result of cash received from the sale of stock for our employee stock purchase plan.

In 2012, cash used in financing activities of $0.7 million was due to the repurchase of our common stock of $0.8 million which was partially offset by cash received from the sale of stock for our employee stock purchase plan of $0.1 million.

Contractual Obligations and Commercial Commitments

As of December 31, 2014, we had no debt. The following table summarizes our contractual obligations as of December 31, 2014 (in thousands):

		Payments due by period			
Contractual obligations:	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Operating lease obligations	$ 11,734	$ 2,188	$ 3,424	$ 3,042	$ 3,080
Purchase obligations	2,143	2,143			
Total	$ 13,877	$ 4,331	$ 3,424	$ 3,042	$ 3,080

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 33,600 square feet of space pursuant to lease that expires on May 31, 2016. 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. Internationally, we lease space in Belgrade, Serbia that expires December 30, 2016.

We lease an additional 19,100 square feet in Aliso Viejo, California under a lease that expires January 31, 2022. In August 2014, we signed an addendum to sublease all of the space commencing on September 15, 2014 for a three year period, with two, two-year renewal options. The remaining lease expense, net of sublease income, has been accrued for in our 2013 restructuring liability account.

We lease approximately 15,300 square feet in Watsonville, California under a lease that expires September 30, 2018. In March 2014, we signed an addendum to sublease all of the space commencing on May 1, 2014. We continued to pay our current monthly rent through June 30, 2014. Beginning on July 1, 2014, we are paying the landlord a minimum amount of rent, with annual escalations, through the end of the lease. This lease expense has been accrued for in our 2013 restructuring liability account. We have moved into a significantly smaller facility in Santa Cruz, California and are paying month-to-month rent.

Off-Balance Sheet Arrangements

As of December 31, 2014, we did not have any off-balance sheet arrangements.

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 they 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:

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 title 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.

On occasion, we enter into fixed fee arrangements, i.e. for trials, in which customer payments are tied to the achievement of specific milestones. Revenue for these contracts is recognized based on customer acceptance of certain milestones as they are achieved. We also enter hosting arrangements that sometimes include up-front, non-refundable set-up fees. Revenue is recognized for these fees over the term of the agreement.

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.

Sales Incentives

For our Productivity & Graphics sales, the cost of sales incentives the Company offers without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction is accounted for as a reduction of revenue as required by FASB ASC Topic No. 605-50, Revenue Recognition Customer Payments and Incentives. We use historical redemption rates to estimate the cost of customer incentives. Total sales incentives were $0.5 million, $1.2 million, and $0.9 million for the years ended December 31, 2014, 2013 and 2012, respectively.

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.

Internal Software Development Costs

Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. The Company considers technological feasibility to be established when all planning, designing, coding and testing has been completed according to design specifications. After technological feasibility is established, any additional costs are

capitalized. Through December 31, 2014, software has been substantially completed concurrently with the establishment of technological feasibility; accordingly, no costs have been capitalized to date.

Table of Contents

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 derecognition, 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 income tax 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 liabilities against gross deferred tax assets); (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 has been in a four-year historical cumulative loss as of the end of fiscal year 2014. These facts, 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, 2014 (as described above), and after consideration of the Company s continuing cumulative loss position as of December 31, 2014, the Company will continue to reserve it s U.S.-based deferred tax amounts, which total $75.7 million, as of December 31, 2014.

The Company is subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. Federal income tax returns of the Company are subject to IRS examination for the 2012 and 2013 tax years. State income tax returns are subject to examination for a period of three to four years after filing. The outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company s tax audits are resolved in a manner not consistent with management s expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. 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 income tax expense.

Table of Contents

Stock-Based 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.

Recent Accounting Pronouncements

In August 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements-Going Concern (Subtopic 205-40*). The Update provides U.S. GAAP guidance on management s responsibility in evaluating whether there is substantial doubt about a company s ability to continue as a going concern and about related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company s ability to continue as a going concern within one year from the date the financial statements are issued. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. We will be evaluating the impact of this guidance on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* The amendments to this Update supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of this Topic is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. This Topic defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. For all entities, the amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. Earlier adoption is not permitted. An entity will be able to use either of two adoption methods: (1) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within this Topic; or (2) retrospective with the cumulative effect of initially applying this Topic recognized at the date of initial application and providing certain additional disclosures as defined per this Topic. We will be evaluating the impact of this guidance on our consolidated financial statements.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our financial instruments include cash and cash equivalents and short-term investments. At December 31, 2014, the carrying values of our financial instruments approximated fair values based on current market prices and rates.

Table of Contents

Foreign Currency Risk

While a majority of our business is denominated in U.S. dollars, we do occasionally invoice in foreign currencies. For the three years ended December 31, 2014, 2013 and 2012, our revenues denominated in foreign currencies were $43,000, $0.1 million, and $0.6 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 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and schedule appear in a separate section of this Annual Report on Form 10-K beginning on page F-1 and S-1, respectively.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. 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 December 31, 2014. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have determined that as of December 31, 2014, 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.

Table of Contents

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 December 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Report of Management on Internal Control Over Financial Reporting

Our management, including the Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934).

Our management, including the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2014. Management based this assessment on criteria for effective internal control over financial reporting described in Internal Control Integrated Framework 2013 issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, management determined that, as of December 31, 2014, we maintained effective internal control over financial reporting.

Item 9B. OTHER INFORMATION

None.

Table of Contents

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth certain information regarding our executive officers and certain key officers as of February 20, 2015:

Name	Age	Position
William W. Smith, Jr.	67	Chairman of the Board, President and Chief Executive Officer
Rick Carpenter	51	Senior Vice President, Engineering
Carla Fitzgerald	50	Vice President, Chief Marketing Officer
Jim Mains	52	Vice President, Chief Strategy Officer
Ken Shebek	52	Vice President, Operations
David P. Sperling	46	Vice President, Chief Technology Officer
Steven M. Yasbek	61	Vice President, Chief Financial Officer

Mr. Smith co-founded Smith Micro and has served as the Chairman of the Board, President and Chief Executive Officer since inception in 1982. Mr. Smith was employed by Rockwell International Corporation in a variety of technical and management positions from 1975 to 1984. Mr. Smith served with Xerox Data Systems from 1972 to 1975 and RCA Computer Systems Division from 1969 to 1972 in mainframe sales and pre-sale technical roles. Mr. Smith received a B.A. in Business Administration from Grove City College.

Mr. Carpenter joined the Company in May 2009 as the Vice President of Engineering for the Company s Connectivity & Security Business Unit and then served as the Vice President and General Manager of the Wireless Business Unit. Mr. Carpenter currently serves as the Senior Vice President of Engineering. Prior to joining Smith Micro, Mr. Carpenter served as a Vice President of Engineering at NextWave Wireless where he was responsible for WiMAX chipset development. From 2000 to 2005, he was Director of Software Engineering for CDMA products at AirPrime, which was ultimately acquired by Sierra Wireless. Mr. Carpenter has also held engineering management positions at Motorola and DENSO Wireless and started his professional career in May of 1986. He holds a BS in Computer Science from the University of Texas, Permian Basin and studied Masters-level Computer Science & Engineering at the University of Texas Arlington.

Ms. Fitzgerald joined the Company in March 2011 as Vice President, Corporate Marketing and has been the Chief Marketing Officer since January 2014. As a veteran of the technology industry, Ms. Fitzgerald has held executive positions in marketing, product management, technical sales and business development positions with Bitfone, WebVisible, LogicalApps, Quest Software, Octave Software and CA (formerly Computer Associates, Systems & Network Management software). She holds a B.A. degree in Economics and Computer Studies from Claremont McKenna College, and sits on the Board of Advisors for the UC Irvine Marketing Extension program.

Mr. Mains joined the Company in November 2009 and has been the Chief Strategy Officer since January 2014. Previously, Mr. Mains has held various positions (Senior Vice President of Products, Solution Engineering, Support, and Program Management) where he focused on innovation and transformation. Prior to joining Smith Micro, Mr. Mains held executive/management positions at Openwave Systems, EMC Corporation, IBM Management Consulting, and several management positions in the Aerospace Industry. He earned his B.S. in Mechanical Engineering at the Pennsylvania State University and M.S. in Interactive Technology and Psychology (AI focus) at the University of Southern California with additional course work at the Wharton School of Business.

Mr. Shebek joined the Company in December 2010 as the Vice President of Operations where he led the Enterprise Mobility Product platform. Mr. Shebek currently is responsible for Information Technology throughout the Company as well as overseeing the Pittsburgh facility. Prior to joining Smith Micro, he was Vice President of Operations for Tollgrade Communications. He also served as Vice President of Supply & Logistics for Ericsson, Inc. and worked for Marconi as Vice President of Supply Chain and served as its Vice President of North American Operations. He joined Fore Systems in 1994, and previously held management positions with IBM. He holds a B.S. in Mechanical Engineering degree from Pennsylvania State University.

Table of Contents

Mr. Sperling joined the Company in April 1989 and has been the Director of Software Engineering since April 1992. He assumed the Chief Technology Officer position in September 1999. Mr. Sperling began his professional career as a software engineer with us and he currently has two patents and three patents pending for various telephony and Internet technologies. He holds a B.S. degree in Computer Science and an MBA from the University of California, Irvine.

Mr. Yasbek joined the Company in May 2008 as the Chief Accounting Officer and assumed the Vice President and Chief Financial Officer position in May 2014. Mr. Yasbek has held executive finance and information technology positions with REMEC, Paradigm Wireless Systems, Intellisys Group, Pacific Scientific Company, Symbol Technologies, and TRW. Prior to joining the Company, Mr. Yasbek was the Chief Financial Officer of Alphatec Spine. He holds a B.S. in Accounting and M.B.A from Loyola Marymount University, and is a Certified Public Accountant.

Officers are elected by, and serve at the discretion of, the Board of Directors.

For information about our Directors, please see the section titled Directors and Executive Officers appearing in our Proxy Statement for our 2015 Annual Meeting of Stockholders, which is hereby incorporated by reference.

The section titled Corporate Governance appearing in our Proxy Statement for our 2015 Annual Meeting of Stockholders is hereby incorporated by reference.

Audit Committee; Audit Committee Financial Expert

Our Board of Directors has a standing Audit Committee. The members of the Audit Committee are Messrs. Campbell, Gulko and Szabo. Our Board has determined that Mr. Gulko, Chairman of the Audit Committee, is an audit committee financial expert as defined by Item 401(h) of Regulation S-K and that each member of the Audit Committee is independent within the meaning of Nasdaq Marketplace Rule 4200(a)(15).

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires certain of the company s executive officers, as well as its directors and persons who own more than ten percent (10%) of a registered class of the Company s equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission.

Based solely on its review of the copies of such forms received by the Company, or written representations from certain reporting persons, the Company believes that all filing requirements applicable to our executive officers, directors and more than 10% stockholders were met in a timely manner in 2014, with the exception of a Form 3 for one director that was filed late.

Code of Ethics

We have adopted a Code of Ethics that applies to all of our employees, including our principal executive officer, our principal financial officer, and all members of our finance department performing similar functions. Our Code of Ethics was filed as Exhibit 14 to the Annual Report on Form 10-K for the year ended December 31, 2003 which was filed on March 25, 2004. In the event of an amendment to, or a waiver from, certain provisions of our Code of Ethics, we intend, to the extent possible, to satisfy Form 8-K disclosure requirements by disclosing this information on our website at www.smithmicro.com.

Table of Contents

Item 11. EXECUTIVE COMPENSATION

The section titled Executive Compensation and Related Information appearing in our Proxy Statement for our 2015 Annual Meeting of Stockholders is hereby incorporated by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The section titled Ownership of Securities and Related Stockholder Matters appearing in our Proxy Statement for our 2015 Annual Meeting of Stockholders is hereby incorporated by reference.

Securities Authorized for Issuance Under An Equity Compensation Plan

The following table provides information as of December 31, 2014 with respect to the shares of common stock that may be issued under our existing equity compensation plans:

(in thousands, except per share amounts)	Number of shares to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of shares remaining available for future issuance
Equity compensation plan approved by shareholders (1)	2,134	$ 5.29	1,571
Equity compensation plan not approved by shareholders			
Total	2,134	$ 5.29	1,571

(1) The number of shares to be issued upon exercise includes options granted under both the 1995 Stock Option/Stock Issuance Plan and the 2005 Stock Option/Stock Issuance Plan. The number of shares remaining available for future issuance consists only of the 2005 Plan.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The section titled Related Party Transactions and Director Independence appearing in our Proxy Statement for our 2015 Annual Meeting of Stockholders is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The section titled Ratification of Appointment of Independent Registered Public Accounting Firm Principal Accountant Fees and Services appearing in our Proxy Statement for our 2015 Annual Meeting of Stockholders is incorporated herein by reference.

39

Table of Contents

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements

Smith Micro s financial statements appear in a separate section of this Annual Report on Form 10-K beginning on the pages referenced below:

	Page
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	F-1
CONSOLIDATED BALANCE SHEETS	F-2
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS	F-3
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY	F-4
CONSOLIDATED STATEMENTS OF CASH FLOWS	F-5
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS	F-6

(2) Financial Statement Schedule

Smith Micro s financial statement schedule appears in a separate section of this Annual Report on Form 10-K on the pages referenced below. All other schedules have been omitted as they are not applicable, not required or the information is included in the consolidated financial statements or the notes thereto.

	Page
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS	S-1

(3) Exhibits

Exhibit No.	Title	Method of Filing
3.1	Amended and Restated Certificate of Incorporation.	Incorporated by reference to Exhibit 3.1 to the Registrant s Registration Statement No. 33-95096.
3.1.1	Amendment to Certificate of Incorporation dated July 11, 2000.	Incorporated by reference to Exhibit 3.1.1 to the Registrant s Quarterly Report on Form 10-Q for the period ended June 30, 2000.
3.1.2	Amendment to Certificate of Incorporation dated August 18, 2005.	Incorporated by reference to Exhibit 3.1.2 to the Registrant s Annual Report on Form 10-K for the period ended December 31, 2005.

Exhibit

No.	Title	Method of Filing
3.1.3	Certificate of Designations of Series A Junior Participating Preferred Stock dated April 25, 2012.	Incorporated by reference to Exhibit 3.1 to the Registrant s Current Report on Form 8-K filed on April 25, 2012.
3.1.4	Amendment to Certificate of Incorporation dated June 25, 2012.	Incorporated by reference to Appendix B to the Registrant s Definitive Proxy Statement on Schedule 14A filed on April 27, 2012.
3.2	Amended and Restated Bylaws.	Incorporated by reference to Exhibit 3.2 to the Registrant s Registration Statement No. 33-95096.
3.3	Amendment to Amended and Restated Bylaws.	Incorporated by reference to Exhibit 3.3 to the Registrant s Current Report on Form 8-K filed on October 31, 2007.
4.1	Specimen certificate representing shares of Common Stock.	Incorporated by reference to Exhibit 4.1 to the Registrant s Registration Statement No. 33-95096.
4.2	Stockholder Rights Agreement, dated as of April 24, 2012, between the Registrant and Computershare Trust Company, N.A., as Rights Agent.	Incorporated by reference to Exhibit 4.1 to the Registrant s Current Report on Form 8-K filed on April 25, 2012.
10.1	Form of Indemnification Agreement.	Incorporated by reference to Exhibit 10.1 to the Registrant s Registration Statement No. 33-95096.
10.2	1995 Stock Option/Stock Issuance Plan as Amended and Restated through February 7, 2001.	Incorporated by reference to Appendix to the Registrant s Definitive Proxy Statement on Schedule 14A filed on April 25, 2001.
10.3	Amended and Restated 2005 Stock Option / Stock Issuance Plan.	Incorporated by reference to Exhibit 10.7 to the Registrant s Registration Statement on Form S-8 (Reg. No. 333-149222).
10.5	Letter Agreement, dated June 13, 2005, by and between the Registrant and Andrew Schmidt.	Incorporated by reference to Exhibit 10.5 to the Registrant s Current Report on Form 8-K filed on November 30, 2006.
10.6	Summary of oral agreement dated June 2005 by and between William W. Smith, Jr. and the Registrant.	Incorporated by reference to Exhibit 10.10 to the Registrant s Quarterly Report on Form 10-Q for the quarter ended June 30, 2009.
10.7	Amended & Restated Employee Stock Purchase Plan.	Incorporated by reference to Exhibit 10.11 to the Registrant s Registration Statement on Form S-8 (No. 333-169671) filed on September 30, 2010.
10.8	Agreement and Mutual General Release, by and between Andrew C. Schmidt and the Registrant.	Incorporated by reference to Exhibit 99.1 to the Registrant s Current Report on Form 8-K filed on May 23, 2014.

Exhibit No.	Title	Method of Filing
10.9	Agreement and Mutual General Release, by and between Christopher G. Lippincott and the Registrant.	Incorporated by reference to Exhibit 99.2 to the Registrant s Current Report on Form 8-K filed on May 23, 2014.
10.10	Agreement and Mutual General Release, by and between Daniel Rawlings and the Registrant.	Incorporated by reference to Exhibit 99.1 to the Registrant s Current Report on Form 8-K filed on June 9, 2014.
10.11	Form of Common Stock Purchase Agreement dated August 15, 2014	Incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on August 20, 2014.
10.12	Form of Registration Rights Agreement dated August 15, 2014.	Incorporated by reference to Exhibit 10.2 to the Registrant s Current Report on Form 8-K filed on August 20, 2014.
14.1	Code of Ethics.	Incorporated by reference to Exhibit 14.1 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2003.
14.1.1	Attachment 1 to Code of Ethics.	Incorporated by reference to Exhibit 14.1.1 to the Registrant s Annual Report on Form 10-K for the year ended December 31, 2003.
21.1	Subsidiaries.	Filed herewith.
23.1	Consent of Independent Registered Public Accounting Firm.	Filed herewith.
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed herewith.
32.1	Certifications of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Furnished herewith.
101.INS	XBRL Instance Document.	Filed herewith.
101.SCH	XBRL Taxonomy Extension Schema Document.	Filed herewith.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.	Filed herewith.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.	Filed herewith.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.	Filed herewith.
101.PRE		Filed herewith.

XBRL Taxonomy Extension Presentation Linkbase
Document.

(b) Exhibits

The exhibits filed as part of this report are listed above in Item 15(a) (3) of this Form 10-K.

(c) Financial Statement Schedule

The Financial Statement Schedule required by Regulation S-X and Item 8 of this Form are listed above in Item 15(a)(2) of this Form 10-K.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: February 27, 2015

By:/s/ William W. Smith, Jr.
William W. Smith, Jr.
Chairman of the Board,
President and Chief Executive Officer
(Principal Executive Officer)

Date: February 27, 2015

By:/s/ Steven M. Yasbek
Steven M. Yasbek
Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ William W. Smith, Jr.	Chairman of the Board,	February 27, 2015
William W. Smith, Jr.	President and Chief Executive Officer (Principal Executive Officer)	
/s/ Steven M. Yasbek	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	February 27, 2015
Steven M. Yasbek		
/s/ Andrew Arno	Director	February 27, 2015
Andrew Arno		
/s/ Thomas G. Campbell	Director	February 27, 2015
Thomas G. Campbell		
/s/ Steven Elfman	Director	February 27, 2015
Steven Elfman		
/s/ Samuel Gulko	Director	February 27, 2015
Samuel Gulko		

/s/ Gregory J. Szabo	Director	February 27, 2015
Gregory J. Szabo		

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Smith Micro Software, Inc.

We have audited the accompanying consolidated balance sheets of Smith Micro Software, Inc. and subsidiaries (collectively, the Company) as of December 31, 2014 and 2013, and the related consolidated statements of comprehensive loss, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2014. Our audits also included the financial statement schedule of the Company listed in Item 15(a). These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2014 and 2013, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ SingerLewak LLP

Los Angeles, California

February 27, 2015

Table of Contents

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and par value data)

	December 31, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 10,165	$ 11,763
Short-term investments	2,880	3,078
Accounts receivable, net of allowances for doubtful accounts and other adjustments of $602 (2014) and $617 (2013)	8,216	7,563
Income tax receivable	706	699
Inventories, net of reserves for excess and obsolete inventory of $151 (2014) and $301 (2013)	97	167
Prepaid expenses and other current assets	765	871
Deferred tax asset		152
Total current assets	22,829	24,293
Equipment and improvements, net	4,273	7,023
Other assets	214	222
Deferred tax asset	74	
Total assets	$ 27,390	$ 31,538
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 1,521	$ 1,632
Accrued liabilities	5,752	7,734
Deferred revenue	1,498	464
Deferred tax liability	74	
Total current liabilities	8,845	9,830
Non-current liabilities:		
Deferred rent and other long term liabilities	3,643	3,383
Deferred tax liability		154
Total non-current liabilities	3,643	3,537
Commitments and contingencies (Note 5)		
Stockholders equity:		
Preferred stock, par value $0.001 per share; 5,000,000 shares authorized; none issued or outstanding		
Common stock, par value $0.001 per share; 100,000,000 shares authorized; 45,000,891 and 36,994,318 shares issued and outstanding at December 31, 2014 and December 31,	45	37

2013, respectively		
Additional paid-in capital	223,141	214,619
Accumulated comprehensive deficit	(208,284)	(196,485)
Total stockholders equity	14,902	18,171
Total liabilities and stockholders equity	$ 27,390	$ 31,538

See accompanying notes to the consolidated financial statements.

F-2

Table of Contents

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands, except per share amount)

	Year ended December 31,		
	2014	**2013**	**2012**
Revenues	$ 36,979	$ 42,675	$ 43,329
Cost of revenues	9,317	9,707	8,448
Gross profit	27,662	32,968	34,881
Operating expenses:			
Selling and marketing	9,559	15,675	16,666
Research and development	14,192	21,305	24,767
General and administrative	13,218	18,216	20,211
Restructuring expenses	2,435	5,602	238
Total operating expenses	39,404	60,798	61,882
Operating loss	(11,742)	(27,830)	(27,001)
Non-operating income:			
Change in fair value of contingent liability			1,210
Interest and other income (expense), net	(8)	30	94
Loss before provision for income taxes	(11,750)	(27,800)	(25,697)
Provision for income tax expense (benefit)	49	153	(234)
Net loss	(11,799)	(27,953)	(25,463)
Other comprehensive income (loss), before tax:			
Unrealized holding gains on available-for-sale securities		7	33
Income tax expense related to items of other comprehensive income			6
Other comprehensive income, net of tax		7	27
Comprehensive loss	$ (11,799)	$ (27,946)	$ (25,436)
Net loss per share:			
Basic and diluted	$ (0.29)	$ (0.76)	$ (0.71)
Weighted average shares outstanding:			
Basic and diluted	40,649	36,982	35,849

See accompanying notes to the consolidated financial statements.

Table of Contents

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Common stock		Additional paid-in capital	Accumulated comprehensive income (deficit)	Total
	Shares	Amount			
BALANCE, December 31, 2011	**35,612**	**$ 36**	**$ 207,927**	**$ (143,103)**	**$ 64,860**
Exercise of common stock options	32		16		16
Non cash compensation recognized on stock options and ESPP			66		66
Restricted stock grants, net of cancellations	574		3,883		3,883
Cancellation of shares for payment of withholding tax	(23)		(40)		(40)
Employee stock purchase plan	53		66		66
Shares repurchased and cancelled	(375)		(753)		(753)
Comprehensive loss				(25,436)	(25,436)
BALANCE, December 31, 2012	**35,873**	**$ 36**	**$ 211,165**	**$ (168,539)**	**$ 42,662**
Non cash compensation recognized on stock options and ESPP			168		168
Restricted stock grants, net of cancellations	1,179	1	3,364		3,365
Cancellation of shares for payment of withholding tax	(96)		(114)		(114)
Employee stock purchase plan	38		36		36
Comprehensive loss				(27,946)	(27,946)
BALANCE, December 31, 2013	**36,994**	**$ 37**	**$ 214,619**	**$ (196,485)**	**$ 18,171**
Exercise of common stock options	4		6		6
Non cash compensation recognized on stock options and ESPP			157		157
Restricted stock grants, net of cancellations	1,421	1	3,494		3,495
Cancellation of shares for payment of withholding tax	(292)		(391)		(391)
Employee stock purchase plan	27		21		21
Issuance of common stock in a private placement	6,846	7	5,235		5,242
Comprehensive loss				(11,799)	(11,799)
BALANCE, December 31, 2014	**45,000**	**$ 45**	**$ 223,141**	**$ (208,284)**	**$ 14,902**

See accompanying notes to the consolidated financial statements.

F-4

Table of Contents

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2014	**2013**	**2012**
Operating activities:			
Net loss	$ (11,799)	$ (27,953)	$ (25,463)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	2,931	4,006	4,430
Long-lived assets write-off due to restructuring		1,011	
Change in fair value of contingent liability			(1,210)
Loss on disposal of fixed assets			163
Provision for adjustments to accounts receivable and doubtful accounts	347	730	1,045
Provision for excess and obsolete inventory	124	76	73
Non cash compensation related to stock options and restricted stock	3,652	3,533	3,949
Deferred income taxes	(2)		
Change in operating accounts:			
Accounts receivable	(1,000)	660	(1,473)
Income tax receivable	(7)	(18)	7,612
Inventories	(54)	(67)	60
Prepaid expenses and other assets	114	(9)	268
Accounts payable and accrued liabilities	(2,189)	2,429	(2,992)
Deferred revenue	1,034	(972)	733
Net cash used in operating activities	(6,849)	(16,574)	(12,805)
Investing activities:			
Capital expenditures	(216)	(829)	(322)
Sales of short-term investments	198	10,257	25,196
Net cash provided by (used in) investing activities	(18)	9,428	24,874
Financing activities:			
Cash received from issuance of common stock, net of offering costs	5,242		
Cash received from stock sale for employee stock purchase plan	21	36	66
Cash received from exercise of stock options	6		16
Repurchase of common stock			(753)
Net cash provided by (used in) financing activities	5,269	36	(671)
Net increase (decrease) in cash and cash equivalents	(1,598)	(7,110)	11,398
Cash and cash equivalents, beginning of period	11,763	18,873	7,475

Cash and cash equivalents, end of period	$ 10,165	$ 11,763	$ 18,873
Supplemental disclosures of cash flow information:			
Cash paid for income taxes	$ 75	$ 165	$ 257

See accompanying notes to the consolidated financial statements.

F-5

Table of Contents

SMITH MICRO SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization, Basis of Presentation and Summary of Significant Accounting Policies

The Company

Smith Micro provides software solutions to simplify and enhance the mobile experience. As a leader in wireless connectivity, our applications ensure the best Quality of Experience for mobile users while optimizing networks for wireless service providers and enterprises. Using our intelligent policy-on-device platform, along with premium voice, video and content monetization services, we create new opportunities to engage consumers and capitalize on the growth of connected devices. In addition to wireless and mobility software, Smith Micro develops and distributes personal, professional and educational productivity and graphics products and tools for consumers, artists, animators and designers worldwide.

Over the past three decades, the Company has developed deep expertise in embedded software for networked devices, policy-based management platforms, and highly-scalable mobile applications and hosted services. For organizations struggling to reduce costs and complexity in the fragmented, rapidly evolving mobile market, Smith Micro offers proven solutions that increase reliability and efficiency while accelerating delivery and *value* of mobile services to consumers.

The proliferation of mobile broadband technology continues to provide new opportunities for Smith Micro on a global scale. Smith Micro s mission is to help our customers thrive in a connected world with software solutions that:

1. Simplify wireless connectivity to reduce costs and deliver best-connected experiences;

2. Optimize network and device resources for maximum performance, efficiency and flexibility;

3. Provide greater insight and control over the quality of service (QoS) delivered to users; and

4. Engage and grow high-value relationships with end customers using mobile devices.

Basis of Presentation

The accompanying consolidated financial statements reflect the operating results and financial position of Smith Micro Software, Inc. and its wholly owned subsidiaries in accordance with accounting principles generally accepted in the United States of America. All intercompany amounts have been eliminated in consolidation.

Foreign Currency Transactions

The Company has international operations resulting from acquisitions in prior years. The countries in which the Company has a subsidiary or branch office in are Serbia, the United Kingdom and Canada. The functional currency for all of these foreign entities is the U.S. dollar in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic No. 830-30, Foreign Currency Matters-Translation of Financial Statements. Foreign currency transactions that increase or decrease expected functional currency cash flows is a foreign currency transaction gain or loss that are included in determining net income for the period in which the exchange rate changes. Likewise, a transaction gain or loss (measured from the transaction date or the most recent

intervening balance sheet date, whichever is later) realized upon settlement of a foreign currency transaction is included in determining net income for the period in which the transaction is settled.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

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 liabilities are considered to be representative of their respective fair values because of the short-term nature of those instruments.

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

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

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

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

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

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

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

Significant Concentrations

For the year ended December 31, 2014, two customers, each accounting for over 10% of revenues, made up 79.2% of revenues and 87% of accounts receivable, and one service provider with more than 10% of purchases totaled 27% of accounts payable. For the year ended December 31, 2013, three customers, each accounting for over 10% of revenues, made up 77.5% of revenues and 83% of accounts receivable, and one service provider with more than 10% of purchases totaled 28% of

accounts payable. For the year ended December 31, 2012, two customers, each accounting for over 10% of revenues, made up 61.2% of revenues and 78% of accounts receivable, and no service provider accounted for more than 10% of purchases.

The Company currently outsources a key information technology service, an important component of one of its products, from one supplier. Although there are a limited number of third party providers for this type of service, management believes that other suppliers could provide similar services on comparable terms. A change in suppliers, however, could cause a disruption or delay in services which could result in a possible loss of revenues and customer confidence, all of which would adversely affect our operating results.

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 December 31, 2014 and 2013, bank balances totaling approximately $9.9 million and $11.6 million, respectively, were uninsured.

Short-Term Investments

Short-term investments consist of corporate notes, bonds, and commercial paper and 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.

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. 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 have also been within management s estimates.

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 December 31, 2014, our net inventory of $0.1 million consisted mostly of components. At December 31, 2013, our net inventory of $0.2 million consisted of $0.1 million of assembled products and $0.1 million of components.

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.

Internal Software Development Costs

Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. The Company considers technological feasibility to be established when all planning, designing, coding and testing has been completed according to design specifications. After technological feasibility is established, any additional costs are capitalized. Through December 31, 2014, software has been substantially completed concurrently with the establishment of technological feasibility; accordingly, no costs have been capitalized to date.

Deferred Rent and Other Long-Term Liabilities

The long-term liabilities are for deferred rent to account for the difference between straight-line and bargain rents, lease incentives included in deferred rent, restructuring expenses, and sublease deposits.

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 title 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.

On occasion, we enter into fixed fee arrangements, i.e. for trials, in which customer payments are tied to the achievement of specific milestones. Revenue for these contracts is recognized based on customer acceptance of certain milestones as they are achieved. We also enter hosting arrangements that sometimes include up-front, non-refundable set-up fees. Revenue is recognized for these fees over the term of the agreement.

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.

Sales Incentives

For our Productivity & Graphics sales, the cost of sales incentives the Company offers without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction is accounted for as a reduction of revenue as required by FASB ASC Topic No. 605-50, Revenue Recognition-Customer Payments and Incentives. We use historical redemption rates to estimate the cost of customer incentives. Total sales incentives were $0.5 million, $1.2 million and $0.9 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Advertising Expense

Advertising costs are expensed as incurred. Advertising expenses were $0.3 million, $0.4 million, and $0.6 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Stock-Based 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.

Net Income (Loss) Per Share

The Company calculates earnings per share (EPS) as required by FASB ASC Topic No. 260, Earning Per Share. Basic EPS is calculated by dividing the net income available to common stockholders by the weighted average number of common shares outstanding for the period, excluding common stock equivalents. Diluted EPS is computed by dividing the net income available to common stockholders by the weighted average number of common shares outstanding for the period plus the weighted average number of dilutive common stock equivalents outstanding for the period determined using the treasury-stock method. For 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.

Table of Contents

	Year Ended December 31,		
	2014	2013	2012
	(in thousands, except per share amounts)		
Numerator:			
Net loss available to common stockholders	($ 11,799)	($ 27,953)	($ 25,463)
Denominator:			
Weighted average shares outstanding - basic	40,649	36,982	35,849
Potential common shares - options (treasury stock method)			
Weighted average shares outstanding - diluted	40,649	36,982	35,849
Shares excluded (anti-dilutive)	150	2	174
Shares excluded due to an exercise price greater than weighted average stock price for the period	1,511	2,150	1,453
Net loss per common share:			
Basic	($ 0.29)	($ 0.76)	($ 0.71)
Diluted	($ 0.29)	($ 0.76)	($ 0.71)

Recent Accounting Pronouncements

In August 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements-Going Concern (Subtopic 205-40*). The Update provides U.S. GAAP guidance on management s responsibility in evaluating whether there is substantial doubt about a company s ability to continue as a going concern and about related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company s ability to continue as a going concern within one year from the date the financial statements are issued. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. We will be evaluating the impact of this guidance on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* The amendments to this Update supersede nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of this Topic is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. This Topic defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. For all entities, the amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. Earlier adoption is not permitted. An entity will be able to use either of two adoption methods: (1) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within this Topic; or (2) retrospective with the cumulative effect of initially applying this Topic recognized at the date of initial application and providing certain additional disclosures as defined per this Topic. We will be evaluating the impact of this guidance on our consolidated financial statements.

2. Restructuring

2014 Restructuring

On May 6, 2014, the Board of Directors approved a plan of restructuring intended to streamline and flatten the Company s organization, reduce overall headcount by approximately 20% and reduce its overall cost structure by approximately $2.0 million per quarter. The restructuring plan resulted in special charges totaling $1.8 million recorded during the three month period ended June 30, 2014. These charges were for non-cash stock-based compensation expense of $1.3 million, severance costs for affected employees of $0.4 million, and other related costs of $0.1 million.

The restructuring plan was implemented primarily during the three month period ending June 30, 2014 and resulted in a negative cash impact of approximately $0.4 million through December 31, 2014. Following is the activity in our restructuring liability account through the period ended December 31, 2014 (in thousands).

	December 31, 2013 Balance	Provision, net	Usage	December 31, 2014 Balance
One-time employee termination benefits	$	$ 1,697	$ (1,697)	$
Fixed asset write-offs, transition travel, other		104	(15)	89
Total	$	$ 1,801	$ (1,712)	$ 89

2013 Restructuring

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 involved a realignment of organizational structures, facility consolidations/closures and headcount reductions of approximately 26% of the Company s worldwide workforce. The restructuring plan was implemented primarily during the three month period ended September 30, 2013 and resulted in annualized savings of approximately $16.0 million.

The restructuring plan resulted in special charges totaling $5.6 million recorded in the year ended December 31, 2013. These charges were for lease/rental terminations of $3.3 million, severance costs for affected employees of $1.1 million, equipment and improvements write-offs as a result of our lease/rental terminations of $1.0 million and other related costs of $0.2 million. All are cash expenditures except for the equipment and improvements write-offs. Approximately $1.1 million of cash expenditures were paid out in 2014, and the remaining cash expenditures will be paid in future years.

In the year ended December 31, 2014, we increased the reserve by $0.6 million due to changes in our assumptions on future sublease income on our lease terminations of $0.8 million, partially offset by adjustments to our one-time employee termination benefits.

Following is the activity in our restructuring liability for the year ended December 31, 2014 (in thousands):

	December 31, 2013 Balance	Provision-net	Usage	December 31, 2014 Balance
One-time employee termination benefits	$ 215	$ (194)	$ (21)	$
Lease/rental terminations	3,115	817	(1,132)	2,800
Fixed asset write-offs, transition travel, other	38	15	(53)	0
Total	$ 3,368	$ 638	$ (1,206)	$ 2,800

Table of Contents

2012 Restructuring

We undertook a restructuring in the fiscal year 2012. Following is the activity in our restructuring liability account for the year ended December 31, 2014 (in thousands):

	December 31, 2013 Balance	Provision, net	Usage	December 31, 2014 Balance
One-time employee termination benefits	$ 4	$ (4)	$	$
Total	$ 4	$ (4)	$	$

For all of these restructuring liabilities, those to be paid within 12 months are included in the accrued liabilities line item on the balance sheet and total $0.9 million. $2.0 million of restructuring is included in the deferred rent and other long-term liabilities line item on the balance sheet.

3. Balance Sheet Details

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):

	December 31, 2014			December 31, 2013		
	Amortized cost basis	Gross unrealized loss	Fair value	Amortized cost basis	Gross unrealized loss	Fair value
Corporate bonds and notes	$ 1,000	$ (1)	$ 999	$ 919	$ (1)	$ 918
Government securities/money market	1,881		1,881	2,160		2,160
Total	$ 2,881	$ (1)	$ 2,880	$ 3,079	$ (1)	$ 3,078

There were no realized gains (losses) recognized in interest and other income for the years ended December 31, 2014 and 2013. There was a de minimis amount of realized gains recognized for the year ended December 31 2012.

Equipment and Improvements

Equipment and improvements consist of the following (in thousands):

	December 31,	
	2014	**2013**
Computer hardware, software, and equipment	$ 16,143	$ 16,529
Leasehold improvements	5,170	5,317
Office furniture and fixtures	1,213	1,213
	22,526	23,059
Less accumulated depreciation and amortization	(18,253)	(16,036)
Equipment and improvements, net	$ 4,273	$ 7,023

Table of Contents

Depreciation and amortization expense on equipment and improvements was $2.9 million, $4.0 million and $4.4 million for the years ended December 31, 2014, 2013 and 2012 respectively.

The Company recorded an impairment charge related to our restructuring against certain equipment and improvements in the amount of $1.0 million for the year ended December 31, 2013. See Note 2 above, Restructuring.

Other Assets

These are office rent deposits.

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	December 31,	
	2014	2013
Salaries and benefits	$ 2,779	$ 3,651
Restructuring	912	1,978
Pennsylvania grant liability	1,000	1,000
Royalties and revenue sharing	835	803
Income taxes	160	176
Marketing expenses, rebates and other	66	126
Total accrued liabilities	$ 5,752	$ 7,734

Deferred Rent and Other Long Term Liabilities

Deferred rent and other long term liabilities consist of the following (in thousands):

	December 31,	
	2014	2013
Deferred rent	$ 1,643	$ 1,986
Restructuring - beyond one year	1,977	1,394
Sublease deposits	23	
Deferred revenue - long term		3
Total deferred rent and other long term liabilities	$ 3,643	$ 3,383

4. Income Taxes

Income (loss) before provision for income taxes was generated from the following sources (in thousands):

	Year Ended December 31,		
	2014	**2013**	**2012**
Domestic	$ (11,867)	$ (27,968)	$ (25,269)
Foreign	117	168	(428)
Total income (loss) before provision for income taxes	$ (11,750)	$ (27,800)	$ (25,697)

Table of Contents

A summary of the income tax expense is as follows (in thousands):

	Year Ended December 31,		
	2014	**2013**	**2012**
Current:			
Federal	$	$	$ 50
State	5	(19)	(440)
Foreign	44	172	156
Total current	49	153	(234)
Deferred:			
Federal			
State			
Foreign			
Total deferred			
Total provision	$ 49	$ 153	$ (234)

A reconciliation of the provision for income taxes to the amount of income tax expense that would result from applying the federal statutory rate to the profit before income taxes is as follows:

	Year Ended December 31,		
	2014	**2013**	**2012**
Federal statutory rate	35%	35%	35%
State tax, net of federal benefit	(1)	4	3
Equity compensation	(7)	(3)	(2)
R&D tax credit			
Other		2	(4)
Change in valuation allowance	(28)	(39)	(31)
	(1)%	(1)%	1%

Table of Contents

The major components of the Company s deferred tax assets and liabilities are as follows (in thousands):

	Year Ended December 31, 2014	2013
Deferred income tax assets		
Net operating loss carry forwards	$ 44,754	$ 38,204
Credit carry forwards	3,708	3,708
Fixed Assets	1,466	1,498
Intangibles	23,029	26,287
Equity based compensation	279	301
Nondeductible accruals	2,382	2,485
Various reserves	149	162
Other	51	36
Valuation Allowance	(75,744)	(72,582)
Total deferred income taxes - net	74	99
Deferred income tax liabilities		
Prepaid expenses	(74)	(101)
Total deferred income liabilities	(74)	(101)
Net deferred income tax assets (liabilities)	$	$ (2)

The Company has federal and state net operating loss (NOL) carryforwards of approximately $101.2 million and $110.4 million, respectively, at December 31, 2014, to reduce future cash payments for income taxes. Of the $101.2 million of NOL carryforwards at December 31, 2014, $0.5 million relates to the excess tax benefits from employee restricted stock. Equity will be increased by $0.5 million if and when such excess tax benefits are ultimately realized. These federal NOL carryforwards will expire from 2024 through 2034 and state NOL carryforwards will expire 2015 through 2034. The Company also had $0.5 million of AMT credit carryforwards with an indefinite life, available to offset regular federal income tax requirements.

The Company has federal and state tax credit carryforwards of approximately $2.5 million and $0.7 million, respectively, at December 31, 2014. These tax credits will begin to expire in 2027.

To the extent that an ownership change has occurred under Internal Revenue Code Sections 382 and 383, the Company s use of its loss carryforwards and credit carryforwards to offset future taxable income may be limited.

At December 31, 2014 and 2013, the Company had unrecognized tax benefits, including interest and penalties of approximately $0.6 million for both years.

The Company s gross unrecognized tax benefits as of December 31, 2014 and 2013 and the changes in those balances are as follows (in thousands):

	Year Ended December 31,	
	2014	**2013**
Beginning Balance	$ 592	$ 592
Increases for tax positions for current year		
Increases/(Decreases) in tax positions for the prior year		
Gross Unrecognized tax benefits, ending balance	$ 592	$ 592

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

Table of Contents

guidance on derecognition, 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 income tax 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 liabilities against gross deferred tax assets); (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 has been in a three-year historical cumulative loss as of the end of fiscal 2012. In addition, the Company is also in a loss for the year ending December 31, 2013 as well as the year ending December 31, 2014. These facts, 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, 2014 (as described above), and after consideration of the Company s continuing cumulative loss position as of December 31, 2014, the Company recorded a valuation allowance related to its U.S.-based deferred tax assets of $75.7 million at December 31, 2014. During fiscal years 2014, 2013 and 2012, the valuation allowance on deferred tax assets increased by $3.2 million, $12.1 million and $7.2 million, respectively.

We recognized interest and penalties accrued related to unrecognized tax benefits in income tax expense. During the fiscal years 2014 and 2013, we recognized approximately $3,000 of interest and penalties each year. The cumulative interest and penalties at December 31, 2014 and 2013 were $44,000 and $41,000, respectively.

Unrecognized tax benefits of $0.2 million at December 31, 2014 would impact the effective tax rate. We anticipate a decrease in gross unrecognized tax benefits of approximately $0.2 million within the next twelve months based on federal, state, and foreign statute expirations.

The Company is subject to U.S. federal income tax as well as to income tax of multiple state jurisdictions. Federal income tax returns of the Company are subject to IRS examination for the 2012 and 2013 tax years. State income tax returns are subject to examination for a period of three to four years after filing. The Company closed their federal audit of 2011 loss carry back claim during the year with no impact to the financial statements. As of December 31, 2014, the Company had no outstanding tax audits. The outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company s tax audits are resolved in a manner not consistent with management s expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs.

Table of Contents

5. 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 December 31, 2014 are as follows (in thousands):

Year Ending December 31,	Operating
2015	$ 2,188
2016	1,888
2017	1,536
2018	1,534
2019	1,508
Beyond	3,080
Total	$ 11,734

As of December 31, 2014, $5.6 million of the remaining lease commitments expense has been accrued as part of the 2013 Restructuring Plan, partially offset by future estimated sublease income of $3.0 million.

Total rent expense was $1.2 million, $2.4 million and $2.7 million for the years ended December 31, 2014, 2013 and 2012, respectively.

As a condition of our new lease in Pittsburgh, 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 remaining 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 carried with it an obligation, or commitment, to employ at least 232 people within a three-year time period that ended on December 31, 2013. We received an extension of time to meet this employment commitment. The new deadline is now February 28, 2015. 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, or until it is determined that we need to return a portion or all of the monies received.

Litigation

The Company 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.

Table of Contents

Other Contingent Contractual Obligations

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include: intellectual property indemnities to the Company s customers and licensees in connection with the use, sale and/or license of Company 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 of the Company; 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. In addition, the Company has made contractual commitments to employees providing for severance payments upon the occurrence of certain prescribed events. The Company 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 the Company could be obligated to make. The Company has not recorded any liability for these indemnities, commitments and guarantees in the accompanying consolidated balance sheets.

6. 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 CommSuite family of products. Productivity & Graphics includes our consumer-based products: Poser, Anime Studio, Manga Studio, MotionArtist and StuffIt.

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

	Year Ended December 31,		
	2014	**2013**	**2012**
Wireless	$ 31,276	$ 35,853	$ 37,154
Productivity & Graphics	5,703	6,822	6,175
Total revenues	36,979	42,675	43,329
Cost of revenues	9,317	9,707	8,448
Gross profit	$ 27,662	$ 32,968	$ 34,881

Table of Contents

Customer Concentration Information

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

	Year Ended December 31,		
	2014	**2013**	**2012**
Wireless:			
Sprint (& affiliates)	68.0%	53.1%	40.7%
Verizon Wireless (& affiliates)	7.8%	13.0%	20.5%
Productivity & Graphics:			
FastSpring	11.2%	11.4%	

The customers listed above comprised 87%, 83% and 78% of our accounts receivable as of December 31, 2014, 2013 and 2012, respectively. Our major customers could reduce their orders of our products in favor of a competitor s product or for any other reason. The loss of any of our major customers or decisions by a significant customer to substantially reduce purchases could have a material adverse effect on our business.

Geographical Information

During the years ended December 31, 2014, 2013 and 2012, the Company operated in three geographic locations: the Americas, Asia Pacific and EMEA (Europe, the Middle East, and Africa). Revenues attributed to the geographic location of the customer s bill-to address, were as follows (in thousands):

	Year ended December 31,		
	2014	**2013**	**2012**
Americas	$ 35,689	$ 38,532	$ 37,724
Asia Pacific	326	928	2,871
EMEA	964	3,215	2,734
Total revenues	$ 36,979	$ 42,675	$ 43,329

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

7. Profit Sharing

The Company offers its employees a 401(k) plan, in which the Company matches the employee contribution at a rate of 20%, subject to a vesting schedule. Total employer contributions amounted to $0.2 million, $0.3 million and $0.3 million for the years ended December 31, 2014, 2013 and 2012, respectively.

8. Stock-Based Compensation

Stock Plans

On July 28, 2005, our Shareholders approved the 2005 Stock Option / Stock Issuance Plan (2005 Plan). The 2005 Plan, which became effective the same date, replaced the 1995 Stock Option / Stock Issuance Plan (1995 Plan), which expired on May 24, 2005. All outstanding options under the 1995 Plan remained outstanding, but no further grants will be made under that Plan.

The 2005 Plan provides for the issuance of non-qualified or incentive stock options and restricted stock to employees, non-employee members of the board and consultants. The exercise price per share for option grants is not to be less than the fair market value per share of the Company s common stock on the date of grant. The Board of Directors has the discretion to determine the vesting schedule. Options may be exercisable immediately or in installments, but generally vest over

a four-year period from the date of grant. In the event the holder ceases to be employed by the Company, all unvested options terminate and all vested options may be exercised within a period following termination. In general, options expire ten years from the date of grant. Restricted stock is valued using the closing stock price on the date of the grant. The total value is expensed over the vesting period of 12 to 48 months. The maximum number of shares of the Company s common stock that were available for issuance over the term of the original 2005 Plan previously could not exceed 5,000,000 shares, plus additional shares equal to 2.5% of the number of shares of common stock outstanding on the last trading day of the calendar year commencing with calendar year 2006, but not in excess of 750,000 shares. On October 11, 2007, our shareholders voted to approve an amendment to the 2005 Plan to increase the maximum number of shares of common stock that may be issued under the 2005 Plan from 5,000,000 shares (plus an annual increase) to 7,000,000 shares (plus an annual increase).

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 purchase period. Additionally, no more than 1,000,000 shares may be purchased under the plan.

Stock Compensation Expense

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.

Valuation of Stock Option and Restricted Stock Awards

The assumptions used to compute the share-based compensation costs for the stock options granted during the years ended December 31, 2014, 2013 and 2012, respectively, using the Black-Scholes option pricing model, were as follows:

	Year Ended December 31,		
	2014	**2013**	**2012**
Weighted average grant-date fair value of stock options	$ 0.57	$ 0.63	$ 0.80
<u>Assumptions</u>			
Risk-free interest rate (weighted average)	1.2%	0.6%	0.5%
Expected dividend yield			
Weighted average expected life (years)	4	4	4
Volatility (weighted average)	82.9%	68.1%	80.0%
Forfeiture rate	25.5%	11.4%	13.7%

The risk-free interest rate assumption was based on the United States Treasury s rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award being valued. The Company assumed no dividend yield because it does not expect to pay dividends for the foreseeable future. The weighted average expected

life is the vesting period for those options granted during that period. The average volatility is based on the actual historical volatility of our common stock. The forfeiture rate was based on modified employee turnover.

Table of Contents

Grants of restricted stock are valued using the closing stock price on the date of grant. In the year ended December 31, 2014, a total of 50,000 shares of restricted stock, with a total value of $0.1 million, were granted to non-employee members of the Board of Directors. This cost will be amortized over a period of 12 months. In addition, 1.6 million shares of restricted stock, with a total value of $2.8 million, were granted to key officers and employees of the Company. This cost will be amortized over a period of 48 months.

Valuation of ESPP

The fair values are estimated at the beginning of each offering period using a Black-Scholes valuation model that uses the assumptions noted in the following table. The risk-free rate is based on the U.S. treasury yield curve in effect at the time of grant. Expected volatility was based on the historical volatility on the day of grant. Following is a schedule of the shares purchased, the fair value per share, and the Black-Scholes model assumptions for each offering period:

Offering Period Ended	**(Ending) March 31, 2015**	**September 30, 2014**	**March 31, 2014**	**September 30, 2013**	**March 31, 2013**
Shares purchased for offering period		13,619	13,734	19,490	18,594
Fair value per share	$ 0.43	$ 0.83	$ 0.30	$ 0.44	$ 0.65
Assumptions					
Risk-free interest rate (average)	0.40%	0.80%	0.40%	0.11%	0.14%
Expected dividend yield					
Weighted average expected life (years)	0.5	0.5	0.5	0.5	0.5
Volatility (average)	109.0%	74.0%	44.0%	45.0%	74.0%

Compensation Costs

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

	Year Ended December 31,		
	2014	**2013**	**2012**
Cost of revenues	$ 13	$ 20	$ 13
Selling and marketing	270	766	865
Research and development	659	809	765
General and administrative	1,437	1,938	2,306
Restructuring expense	1,273		
Total non-cash stock compensation expense	$ 3,652	$ 3,533	$ 3,949

Total share-based compensation for each year includes cash payment of income taxes related to grants of restricted stock in the amounts of $0.2 million, $0.4 million and $0.4 million for the years ended December 31, 2014, 2013 and 2012, respectively.

Table of Contents

Stock Options

A summary of the Company s stock options outstanding under the 2005 Plan as of December 31, 2014 and the activity during the years ended herein are as follows (in thousands except per share amounts):

	Shares	Weighted Ave. Exercise Price		Aggregate Intrinsic Value
Outstanding as of December 31, 2011	**2,167**	**$**	**11.03**	**$**
(2,167 options exercisable at a weighted average exercise price of $11.03)				
Granted (weighted average fair value of $0.80)	826	$	1.39	
Exercised	(32)	$	0.50	
Cancelled	(686)	$	12.37	
Outstanding as of December 31, 2012	**2,275**	**$**	**7.02**	**$**
(1,474 options exercisable at a weighted average exercise price of $10.09)				
Granted (weighted average fair value of $0.63)	120	$	1.31	
Exercised		$		
Cancelled	(225)	$	6.52	
Outstanding as of December 31, 2013	**2,170**	**$**	**6.76**	**$**
(1,573 options exercisable at a weighted average exercise price of $8.81)				
Granted (weighted average fair value of $0.57)	633	$	0.95	
Exercised	(4)	$	1.38	
Cancelled	(665)	$	5.98	
Outstanding as of December 31, 2014	**2,134**	**$**	**5.29**	**$**
Exercisable as of December 31, 2014	1,291	$	8.04	$
Vested and expected to vest at December 31, 2014	1,963	$	5.66	$

During the year ended December 31, 2014, options to acquire 4,000 shares were exercised resulting in cash proceeds to the Company of $6,000. The weighted-average grant-date fair value of options granted during the year ended December 31, 2014 was $0.57. As of December 31, 2014, there is $3.3 million of unrecognized compensation costs related to non-vested stock options and restricted stock granted under the Plan. At December 31, 2014, there were 1.6 million shares available for future grants under the 2005 Stock Issuance / Stock Option Plan.

Restricted Stock Awards

A summary of the Company s restricted stock awards outstanding under the 2005 Plan as of December 31, 2014, and the activity during years ended therein, are as follows (in thousands):

	Number of shares	Weighted average grant date fair value	
Unvested at December 31, 2011	1,355	$	3.21
Granted	995	$	2.64
Vested	(611)	$	6.42
Cancelled and forfeited	(420)	$	8.73
Unvested at December 31, 2012	1,319	$	4.60
Granted	1,495	$	1.70
Vested	(752)	$	4.43
Cancelled and forfeited	(316)	$	3.00
Unvested at December 31, 2013	1,746	$	2.48
Granted	1,625	$	1.79
Vested	(1,442)	$	2.48
Cancelled and forfeited	(204)	$	1.79
Unvested at December 31, 2014	1,725	$	1.91

9. Equity Transactions

On August 15, 2014, the Company entered into a common stock purchase agreement with a number of accredited investors (Investors) in a private placement pursuant to which the Company issued and sold to the Investors 6,845,830 shares of its common stock at a price per share of $0.816. The transaction closed on August 20, 2014 and the Company realized gross proceeds of $5.6 million before deducting commissions and other expenses. Offering costs related to the transaction totaled $0.4 million, comprised of $0.2 million of commissions and $0.2 million of legal and other expenses, resulting in net proceeds of $5.2 million. The Company filed a registration statement with the SEC providing for the resale of the shares of Common Stock issued pursuant to the Purchase Agreement. The registration statement became effective on September 25, 2014.

10. 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. The Company repurchased 375,000 shares at a cost of $0.8 million during fiscal year 2012. The Company did not repurchase any shares in fiscal year 2013. The program ended on November 1, 2013.

11. 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 there are no further disclosures required.

Table of Contents

12. Quarterly Financial Data (Unaudited)

The following financial information reflects all normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of the results of the interim periods. Summarized quarterly data for fiscal 2014 and 2013 are as follows (in thousands, except per share data):

	Year ended December 31, 2014			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Selected quarterly financial data:				
Revenues	$ 8,449	$ 8,528	$ 9,448	$ 10,544
Gross profit	$ 6,029	$ 6,077	$ 7,247	$ 8,309
Operating income (loss)	$ (5,134)	$ (5,681)	$ (1,144)	$ 217
Net income (loss)	$ (5,167)	$ (5,695)	$ (1,142)	$ 205
Net (loss) per share, basic (1)	$ (0.14)	$ (0.15)	$ (0.03)	$ 0.00
Weighted average shares outstanding, basic	37,714	38,518	41,225	45,053
Net (loss) per share, diluted (1)	$ (0.14)	$ (0.15)	$ (0.03)	$ 0.00
Weighted average shares outstanding, diluted	37,714	38,518	41,225	45,053

	Year ended December 31, 2013			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Selected quarterly financial data:				
Revenues	$ 11,602	$ 10,484	$ 8,746	$ 11,843
Gross profit	$ 9,158	$ 8,083	$ 6,254	$ 9,473
Operating (loss)	$ (6,101)	$ (7,248)	$ (12,980)	$ (1,501)
Net (loss)	$ (6,158)	$ (7,244)	$ (13,049)	$ (1,502)
Net (loss) per share, basic (1)	$ (0.17)	$ (0.19)	$ (0.35)	$ (0.04)
Weighted average shares outstanding, basic	36,614	37,247	37,036	37,027
Net (loss) per share, diluted (1)	$ (0.17)	$ (0.19)	$ (0.35)	$ (0.04)
Weighted average shares outstanding, diluted	36,614	37,247	37,036	37,027

(1) Basic and diluted net (loss) per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly per share amounts will not necessarily equal the total for the year.

Table of Contents

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

FOR EACH OF THE THREE YEARS

IN THE PERIOD ENDED DECEMBER 31, 2014

(In thousands)

	Balance at beginning of period	Additions charged to costs and expenses	Deductions	Balance at end of period
Allowance for accounts receivable (1):				
2014	$ 617	$ 347	$ (362)	$ 602
2013	482	730	(595)	617
2012	1,382	1,045	(1,945)	482
Allowance for excess and obsolete inventory:				
2014	$ 301	$ 124	$ (274)	$ 151
2013	352	76	(127)	301
2012	417	73	(138)	352

(1) Allowances are for retail return reserves, marketing development funds and doubtful accounts.

S-1