

SMITH MICRO SOFTWARE INC  
Form 10-Q  
November 05, 2009

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2009  
OR**

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

**Commission file number 0-26536  
SMITH MICRO SOFTWARE, INC.  
(Exact name of registrant as specified in its charter)**

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

**33-0029027**  
(I.R.S. Employer  
Identification No.)

**51 COLUMBIA  
ALISO VIEJO, CA 92656**  
(Address of principal executive offices, including zip code)  
**(949) 362-5800**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

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

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

Yes  No

As of October 31, 2009 there were 33,362,000 shares of common stock outstanding.



**SMITH MICRO SOFTWARE, INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**September 30, 2009**  
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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**SMITH MICRO SOFTWARE, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and par value data)

	September 30, 2009 (unaudited)	December 31, 2008 (audited)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 16,175	\$ 13,966
Short-term investments	32,361	22,649
Accounts receivable, net of allowances for doubtful accounts and other adjustments of \$1,479 (2009) and \$1,204 (2008)	23,293	18,424
Inventories, net of reserves for obsolete inventory of \$1,118 (2009) and \$404 (2008)	506	1,097
Prepaid expenses and other current assets	798	869
Deferred tax asset	1,658	1,698
 Total current assets	 74,791	 58,703
Equipment and improvements, net	7,046	4,289
Goodwill	83,483	83,483
Intangible assets, net	21,187	27,603
Other assets	160	157
Deferred tax asset	2,760	2,760
 Total assets	 \$ 189,427	 \$ 176,995
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 4,162	\$ 3,492
Accrued liabilities	4,936	6,710
Deferred revenue	2,331	923
 Total current liabilities	 11,429	 11,125
Long-term liabilities	211	466
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value \$0.001 per share; 5,000,000 shares authorized; none issued or outstanding		
Common stock, par value \$0.001 per share; 50,000,000 shares authorized; 32,662,000 and 31,400,000 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	33	31
Additional paid-in capital	174,759	165,864
Accumulated other comprehensive income	19	69
Accumulated earnings (deficit)	2,976	(560)

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Total stockholders' equity	177,787	165,404
Total liabilities and stockholders' equity	\$ 189,427	\$ 176,995

See accompanying notes to the consolidated financial statements.

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**SMITH MICRO SOFTWARE, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues	\$ 27,820	\$ 26,641	\$ 77,594	\$ 71,973
Cost of revenues	3,540	5,197	11,985	15,776
Gross profit	24,280	21,444	65,609	56,197
Operating expenses:				
Selling and marketing	5,946	6,255	18,371	18,829
Research and development	9,229	8,199	26,066	23,121
General and administrative	4,967	4,941	13,962	14,555
Total operating expenses	20,142	19,395	58,399	56,505
Operating income (loss)	4,138	2,049	7,210	(308)
Interest and other income	121	104	495	520
Profit before taxes	4,259	2,153	7,705	212
Income tax expense	2,278	3,729	4,169	2,263
Net income (loss)	\$ 1,981	\$ (1,576)	\$ 3,536	\$ (2,051)
Net income (loss) per share:				
Basic	\$ 0.06	\$ (0.05)	\$ 0.11	\$ (0.07)
Diluted	\$ 0.06	\$ (0.05)	\$ 0.11	\$ (0.07)
Weighted average shares outstanding:				
Basic	32,523	31,289	32,182	30,856
Diluted	33,145	31,289	32,641	30,856

See accompanying notes to the consolidated financial statements.

**SMITH MICRO SOFTWARE, INC.**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**  
(in thousands)

	Common stock		Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated income (deficit)	Total
	Shares	Amount				
<b>BALANCE, December 31, 2008</b>	<b>31,400</b>	<b>\$ 31</b>	<b>\$ 165,864</b>	<b>\$ 69</b>	<b>\$ (560)</b>	<b>\$ 165,404</b>
Exercise of common stock options	404	1	1,615			1,616
Non cash compensation recognized on stock options			4,053			4,053
Restricted stock grants	875	1	2,606			2,607
Cancellation of shares for payment of withholding tax	(17)		(118)			(118)
Excess tax benefit related to stock compensation			779			779
Tax deficiencies related to stock compensation			(40)			(40)
Other comprehensive income:						
Change in unrealized loss on short-term investments				(50)		(50)
Net income					3,536	3,536
Total comprehensive income						3,486
<b>BALANCE, September 30, 2009</b>	<b>32,662</b>	<b>\$ 33</b>	<b>\$ 174,759</b>	<b>\$ 19</b>	<b>\$ 2,976</b>	<b>\$ 177,787</b>

See accompanying notes to the unaudited consolidated financial statements.

**SMITH MICRO SOFTWARE, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Nine Months Ended September 30,	
	2009 (unaudited)	2008 (unaudited)
<b>Operating activities:</b>		
Net income (loss)	\$ 3,536	\$ (2,051)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities, net of the effect of acquisitions:		
Depreciation and amortization	7,645	6,459
Loss on disposal of assets	20	
Provision for doubtful accounts and other adjustments to accounts receivable	1,190	637
Provision for excess and obsolete inventory	896	270
Tax benefits from stock-based compensation	(779)	(78)
Non cash compensation related to stock options & restricted stock	6,541	9,177
Change in operating accounts, net of effect from acquisitions:		
Accounts receivable	(6,059)	(8,030)
Deferred income taxes		1,394
Income tax receivable		(82)
Inventories	(305)	472
Prepaid expenses and other assets	68	151
Accounts payable and accrued liabilities	828	196
Net cash provided by operating activities	13,581	8,515
<b>Investing activities:</b>		
Adjustments made to the acquisition of eFrontier America		(686)
Adjustments made to the acquisition of Insignia Solutions		245
Acquisition of PCTel s Mobility Solutions Group, net of cash received		(60,911)
Other intangibles		(500)
Capital expenditures	(4,006)	(3,161)
Purchase of short-term investments	(9,762)	(6,301)
Net cash used in investing activities	(13,768)	(71,314)
<b>Financing activities:</b>		
Tax benefits from stock-based compensation	779	78
Cash received from exercise of stock options	1,617	129
Net cash provided by financing activities	2,396	207
Net increase (decrease) in cash and cash equivalents	2,209	(62,592)
Cash and cash equivalents, beginning of period	13,966	87,549



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Cash and cash equivalents, end of period	\$ 16,175	\$ 24,957
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	\$ 5,189	\$ 417

See accompanying notes to the consolidated financial statements.

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**SMITH MICRO SOFTWARE, INC.**  
**Notes to the Consolidated Financial Statements**

**1. The Company**

Smith Micro Software, Inc. ( we, us, our, Smith Micro, or the Company ) designs, develops and markets mobile software products and services and an extensive line of personal computing graphic and utility software products. We sell our products and services to many of the world's leading wireless mobile device operators (carriers and cable), mobile device original equipment manufacturers ( OEM ), personal computer ( PC ) manufacturers, and enterprise businesses, as well as directly to consumers.

On September 9, 2009, we agreed to acquire Core Mobility, Inc. ( Core Mobility ), a developer of mobility software and solutions, for \$10 million in cash and 700,000 shares of Smith Micro common stock. The transaction closed on October 26, 2009, and Core Mobility became a wholly-owned subsidiary of Smith Micro. In addition, the former shareholders of Core Mobility have the ability to earn additional cash consideration of up to \$1.9 million in the form of earn-out payments, contingent on Core Mobility achieving certain milestone deliverables for product development and deployment. Acquisition-related costs of \$0.1 million were recorded in the period ended September 30, 2009 in the general and administrative section of the consolidated statement of operations.

**2. Basis of Presentation**

In June 2009, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles - a replacement of FASB Statement No. 162*. SFAS No. 168 became the source of authoritative U.S. generally accepted accounting principles ( GAAP ) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission ( SEC ) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification superseded all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification became nonauthoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has adopted SFAS No. 168 on its effective date and it is incorporated in this 10-Q SEC filing.

The accompanying interim consolidated balance sheet and statement of equity as of September 30, 2009, and the related statements of operations and cash flows for the nine months ended September 30, 2009 and 2008 are unaudited. The unaudited consolidated financial statements have been prepared according to the rules and regulations of the SEC and, therefore, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted.

In the opinion of management, the accompanying unaudited consolidated financial statements for the periods presented reflect all adjustments, which are normal and recurring, necessary to fairly state the financial position, results of operations and cash flows. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K and 10-K/A for the fiscal year ended December 31, 2008 filed with the SEC on March 10, 2009 and April 29, 2009, respectively.

Intercompany balances and transactions have been eliminated in consolidation.

Certain prior year amounts on the balance sheet have been reclassified to conform to the current year presentation.

Operating results for the three and nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2009.

**3. Net Income (Loss) Per Share**

The Company calculates earnings per share ( EPS ) as required by the Earnings Per Share Topic of the FASB Accounting Standards Codification. Basic EPS is calculated by dividing the net income/loss 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.



	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(unaudited, in thousands, except per share amounts)			
<b>Numerator:</b>				
Net income (loss) available to common stockholders	\$ 1,981	\$ (1,576)	\$ 3,536	\$ (2,051)
<b>Denominator:</b>				
Weighted average shares outstanding basic	32,523	31,289	32,182	30,856
Potential common shares options (treasury stock method)	622		459	
Weighted average shares outstanding diluted	33,145	31,289	32,641	30,856
Shares excluded (anti-dilutive)		3,111		3,110
Shares excluded due to an exercise price greater than weighted average stock price for the period	2,462		2,501	
Net income (loss) per common share:				
Basic	\$ 0.06	(\$0.05)	\$ 0.11	(\$0.07)
Diluted	\$ 0.06	(\$0.05)	\$ 0.11	(\$0.07)

#### 4. 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).

*Stock Compensation*

Effective January 1, 2006, the Company started to measure and recognize compensation expense for all stock-based payment awards made to employees and directors, including stock options based on their fair values as required by the Compensation-Stock Compensation Topic of the FASB Accounting Standards Codification. The Company used the modified prospective transition method as of January 1, 2006. In accordance with the modified prospective transition method, the Company's financial statements for prior periods have not been restated to reflect, and do not include, the impact of stock compensation expense.

Stock-based compensation expense recognized is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the Company's consolidated statement of operations during the three and nine months ended September 30, 2009 and 2008 includes compensation expense for stock-based payment awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions.

*Valuation of Stock Option and Restricted Stock Awards*

The weighted average grant-date fair value of stock options granted during the three and nine months ended September 30, 2009 was \$3.23 for both periods. The weighted average grant-date fair value of stock options granted during the three and nine months ended September 30, 2008 was \$2.32 and \$3.74, respectively. The assumptions used to compute the share-based compensation costs for the stock options granted during the three and nine months ended September 30, 2009 and 2008, using the Black-Scholes option pricing model, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009 (unaudited)	2008 (unaudited)	2009 (unaudited)	2008 (unaudited)
<b><i>Employee Stock Options</i></b>				
Risk-free interest rate	0.5%	2.2%	0.5%	2.8%
Expected dividend yield				
Weighted average expected life (years)	1	1	1	4
Volatility	71.0%	72.0%	71.0%	71.0%
Forfeiture rate				3.5%

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.

Grants of restricted stock are valued using the closing stock price on the date of grant. In the nine months ended September 30, 2009, a total of 50,000 shares of restricted stock, with a total value of \$0.2 million, were granted to members of the Board of Directors. This cost will be amortized over a period of 12 months. In addition, 0.9 million shares of restricted stock, with a total value of \$4.4 million, were granted to key officers and employees of the Company. This cost will be amortized over a period of 48 months.

*Compensation Costs*

As required by the Compensation-Stock Compensation Topic of the FASB Accounting Standards Codification, the Company elected to attribute the value of stock-based compensation to expense using the straight-line method over the requisite service period for each award, which was previously used for its pro forma information. Stock-based non-cash compensation expenses related to stock options and restricted stock grants were recorded in the financial statements as follows (in thousands):

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2009	2008	2009	2008
Cost of revenues	\$ 28	\$ 99	\$ 157	\$ 331
Selling and marketing	592	760	1,898	2,727
Research and development	643	835	1,899	2,483
General and administrative	782	1,306	2,706	3,636
Total non-cash stock compensation expense	\$ 2,045	\$ 3,000	\$ 6,660	\$ 9,177

Total stock-based compensation for each quarter includes cash payment of income taxes related to grants of restricted stock in the amount of \$0.4 million for both the three months ended September 30, 2009 and 2008. The cash payment of income taxes related to grants of restricted stock totaled \$0.8 million for the nine months ended September 30, 2009 and \$0.9 million for the nine months ended September 30, 2008.

*Stock Options*

A summary of the Company's stock options outstanding under the 2005 Plan as of September 30, 2009, and the activity during the nine months then ended, are as follows:

	<b>Shares</b>	<b>Weighted Ave. Exercise Price</b>	<b>Aggregate Intrinsic Value</b>
	<b>(in thousands except per share amounts)</b>		
Outstanding as of December 31, 2008	4,289	\$ 10.94	
Granted (unaudited)	25	\$ 11.59	
Exercised (unaudited)	(404)	\$ 4.00	
Cancelled (unaudited)	(359)	\$ 14.58	
Outstanding as of September 30, 2009 (unaudited)	3,551	\$ 11.27	\$
			&nb