

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 company   
(Do not check if a smaller reporting company)

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

Yes  No

As of 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<br>30,<br>2009<br>(unaudited) | December<br>31,<br>2008<br>(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                                |
| <b>Total current assets</b>  | <b>74,791</b>                           | <b>58,703</b>                        |
| 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                                |
| <b>Total assets</b>  | <b>\$ 189,427</b>                       | <b>\$ 176,995</b>                    |
| <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                                  |
| <b>Total current liabilities</b>   | <b>11,429</b>                           | <b>11,125</b>                        |
| 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 |             | Nine Months Ended |             |
|--------------------------------------|--------------------|-------------|-------------------|-------------|
|                                      | September 30,      |             | 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<br>paid-in<br>capital | Accumulated<br>other<br>comprehensive<br>income<br>(loss) | Accumulated<br>income<br>(deficit) | Total             |
|---|---------------|--------------|----------------------------------|---|------------------------------------|-------------------|
|   | Shares        | Amount       |                                  |   |                                    |                   |
| <b>BALANCE,<br/>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,<br/>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                        | 2008        |
|   | (unaudited)                 | (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<br>September 30,                 |            | Nine Months Ended September<br>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<br>September 30, |                     | Nine Months Ended<br>September 30, |                     |
|--|-------------------------------------|---------------------|------------------------------------|---------------------|
|  | 2009<br>(unaudited)                 | 2008<br>(unaudited) | 2009<br>(unaudited)                | 2008<br>(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<br>September 30,<br>(unaudited) |          | Nine Months Ended<br>September 30,<br>(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:

|  | Shares<br>(in thousands except per share amounts) | Weighted<br>Ave.<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value |
|--|---|---------------------------------------|---------------------------------|
| 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                              | \$                              |
| Exercisable as of September 30, 2009 (unaudited) | 2,606   | \$ 10.33                              | \$ 5,277                        |

During the nine months ended September 30, 2009, options to acquire 404,000 shares were exercised with an intrinsic value of \$3.4 million, resulting in cash proceeds to the Company of \$1.6 million. The weighted average grant date fair value of options granted during the nine months ended September 30, 2009 was \$3.23. For the three months ended September 30, 2009, there were \$6.6 million of total unrecognized compensation costs related to non-vested stock options granted under the Plan, which will be recognized over a period not to exceed four years. At September 30, 2009, there were 1.4 million shares available for future grants under the 2005 Plan.

Additional information regarding options outstanding as of September 30, 2009 is as follows:

| Range of<br>exercise<br>prices | Number<br>outstanding<br>(in thousands) | Options outstanding   |  | Options exercisable                     |  |
|--------------------------------|---|---|--|---|--|
|                                |   | Weighted<br>average<br>remaining<br>contractual<br>life (years) | Weighted<br>average<br>exercise<br>price | Number<br>exercisable<br>(in thousands) | Weighted<br>average<br>exercise<br>price |
| \$0.24 - \$4.00                | 188                                     | 4.4   | \$ 1.56                                  | 188                                     | \$ 1.56                                  |
| \$4.01 - \$6.00                | 695                                     | 5.8   | \$ 4.95                                  | 694                                     | \$ 4.95                                  |
| \$6.01 - \$12.00               | 306                                     | 7.4   | \$ 8.99                                  | 231                                     | \$ 9.08                                  |
| \$12.01 - \$14.00              | 1,309                                   | 7.4   | \$12.68                                  | 851                                     | \$12.69                                  |
| \$14.01 - \$16.00              | 673                                     | 7.5   | \$15.18                                  | 425                                     | \$15.18                                  |
| \$16.01 - \$19.00              | 380                                     | 7.7   | \$17.73                                  | 217                                     | \$17.81                                  |
|                                | 3,551                                   | 7.0   | \$11.27                                  | 2,606                                   | \$10.33                                  |

#### *Restricted Stock Awards*

A summary of the Company's restricted stock awards outstanding under the 2005 Plan as of September 30, 2009, and the activity during the nine months then ended, are as follows (in thousands):

|                               | Shares |
|-------------------------------|--------|
| Unvested at December 31, 2008 | 998    |
| Granted (unaudited)           | 963    |
| Vested (unaudited)            | (353)  |
| Cancelled (unaudited)         | (88)   |



Unvested at September 30, 2009 (unaudited)

1,520

**5. Fair Value of Financial Instruments**

The Company measures and discloses fair value measurements as required by as required by the Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification.

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

As required by the Financial Instruments Topic of the FASB Accounting Standards Codification, 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 the Investments-Debt and Equity Topic of the FASB Accounting Standards Codification. We have made this election because the nature of our financial assets and liabilities are not of such complexity that they would benefit from a change in valuation to fair value.

#### 6. Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash, government securities, mutual funds, and money market funds. These securities are primarily held in two financial institutions and are uninsured except for the minimum Federal Deposit Insurance Corporation ( FDIC ) coverage, and have original maturity dates of three months or less. As of September 30, 2009 and December 31, 2008, bank balances totaling approximately \$4.5 million and \$14.0 million, respectively, were uninsured.

#### 7. Short-Term Investments

Short-term investments consist of U.S. government agency and government sponsored enterprise obligations. The Company accounts for these short-term investments as required by the Investments-Debt and Equity Topic of the FASB Accounting Standards Codification. 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 shareholders' equity until realized. All securities are accounted for on a specific identification basis. As of September 30, 2009, the following available-for-sale securities were in a gain position (in thousands):

|  | <b>Fair<br/>value</b> | <b>(unaudited)<br/>Unrealized<br/>gain</b> |
|--|-----------------------|--|
| Holding period of less than 12 months: |                       |  |
| Corporate bonds and notes              | \$ 7,047              | \$ 3                                       |
| Government securities                  | 25,314                | 16   |
| Total                                  | \$ 32,361             | \$ 19                                      |

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 the Financial Instruments Topic of the FASB Accounting Standards Codification, 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.

For the nine months ended September 30, 2009, realized losses on our short-term investments were \$0.1 million, and is reported in the interest and other income line on the consolidated statements of operations.

## 8. Accounts Receivable

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

## 9. Inventories

Inventories consist principally of cables, 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 September 30, 2009, our net inventory balance of \$0.5 million consisted of approximately \$0.1 million of assembled products and \$0.4 million of components.

## 10. Equipment and Improvements

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

## 11. Goodwill

As required by the Intangibles-Goodwill and Other Topic of the FASB Accounting Standards Codification, the Company reviews the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. The Company's annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the fair value of the Company's reporting units to the carrying value of the underlying net assets in the reporting units. If the fair value of a reporting unit is determined to be less than the carrying value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the fair value of the reporting unit and the fair value of its other assets and liabilities. We determined that we did not have any impairment of goodwill at December 31, 2008. We also noted that during the nine months ended September 30, 2009, there were no impairment indicators for goodwill.

The carrying amount of the Company's goodwill was \$83.5 million as of September 30, 2009 and December 31, 2008.

## 12. Intangible Assets

The following table sets forth our acquired intangible assets by major asset class as of September 30, 2009 and December 31, 2008 (dollars in thousands):

|                        | Useful<br>Life<br>(Years) | September 30, 2009 (unaudited) |                             |                      | December 31, 2008 |                             |                      |
|------------------------|---------------------------|--------------------------------|-----------------------------|----------------------|-------------------|-----------------------------|----------------------|
|                        |                           | Gross                          | Accumulated<br>Amortization | Net<br>Book<br>Value | Gross             | Accumulated<br>Amortization | Net<br>Book<br>Value |
| Amortizing:            |                           |                                |                             |                      |                   |                             |                      |
| Purchased              |                           |                                |                             |                      |                   |                             |                      |
| Technology             | 1                         | \$ 3,047                       | \$ (2,827)                  | \$ 220               | \$ 3,047          | \$ (1,836)                  | \$ 1,211             |
| Capitalized Software   | 5-7                       | 23,846                         | (10,432)                    | 13,414               | 23,846            | (6,899)                     | 16,947               |
| Distribution Rights    | 5                         | 482                            | (430)                       | 52                   | 482               | (377)                       | 105                  |
| Customer Lists         | 5                         | 1,484                          | (955)                       | 529                  | 1,484             | (676)                       | 808                  |
| Database               | 10                        | 182                            | (33)                        | 149                  | 182               | (20)                        | 162                  |
| Trademarks             | 10                        | 809                            | (425)                       | 384                  | 809               | (375)                       | 434                  |
| Trade Names            | 1-2                       | 2,121                          | (706)                       | 1,415                | 2,121             | (406)                       | 1,715                |
| Customer<br>Agreements | 4-7                       | 1,135                          | (1,014)                     | 121                  | 1,135             | (650)                       | 485                  |

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|                        |     |           |             |           |           |             |           |
|------------------------|-----|-----------|-------------|-----------|-----------|-------------|-----------|
| Customer Relationships | 1-9 | 7,020     | (2,117)     | 4,903     | 7,020     | (1,284)     | 5,736     |
| Totals                 |     | \$ 40,126 | \$ (18,939) | \$ 21,187 | \$ 40,126 | \$ (12,523) | \$ 27,603 |

Aggregate amortization expense on intangible assets was \$2.1 million and \$6.4 million for the three and nine months ended September 30, 2009, respectively. Expected future amortization expense is as follows: \$1.9 million for the remainder of 2009, \$5.9 million for 2010, \$5.5 million for 2011, \$4.8 million for 2012, \$2.3 million for 2013, and \$0.8 million thereafter.

### 13. Other Assets

Deposits have been reclassified from prepaid expenses and other current assets. These are primarily office rent deposits.

### 14. Comprehensive Income

Comprehensive income includes unrealized gains and losses on short-term investments of U.S. government agency and government sponsored enterprise debt and equity securities. The following table sets forth the calculation of comprehensive income (in thousands):

|   | Three Months Ended<br>September 30,<br>(unaudited) |            | Nine Months Ended<br>September 30,<br>(unaudited) |            |
|---|--|------------|---|------------|
|   | 2009   | 2008       | 2009  | 2008       |
| Net income (loss)                             | \$ 1,981   | \$ (1,576) | \$ 3,536  | \$ (2,051) |
| Change in unrealized gain on investments, net | (13)   | (30)       | (50)  | (30)       |
| Total comprehensive income (loss)             | \$ 1,968   | \$ (1,606) | \$ 3,486  | \$ (2,081) |

### 15. Segment and Geographical Information

#### Segment Information

Public companies are required to report financial and descriptive information about their reportable operating segments as required by the Segment Reporting Topic of the FASB Accounting Standards Codification. The Company identifies its operating segments based on how management internally evaluates separate financial information, business activities and management responsibility. The Company has two primary business units. Wireless includes our connection manager solutions for the OEM and Enterprise channels, music, photo and video content management, firmware over the air and products for the IMS application layer. Productivity & Graphics includes retail sales of our compression and broad consumer-based software. Corporate/Other revenue includes the consulting portion of our services sector which has been de-emphasized and is no longer considered a strategic element of our future plans.

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

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

|                         | Three Months Ended<br>September 30,<br>(unaudited) |           | Nine Months Ended<br>September 30,<br>(unaudited) |           |
|-------------------------|--|-----------|---|-----------|
|                         | 2009   | 2008      | 2009  | 2008      |
| Wireless                | \$ 22,665  | \$ 19,919 | \$ 63,295   | \$ 52,911 |
| Productivity & Graphics | 4,986  | 6,396     | 13,569  | 18,101    |
| Corporate/Other         | 169  | 326       | 730   | 961       |
| Total Revenues          | \$ 27,820  | \$ 26,641 | \$ 77,594   | \$ 71,973 |

Sales to three customers and their respective affiliates in the Wireless business segment accounted for 33.0%, 12.0%, and 11.0% of the Company's total revenues for the three months ended September 30, 2009. Sales to two customers in the Wireless business segment accounted for 26.2% and 11.5% of the Company's total revenues for the

three months ended September 30, 2008. Sales to two customers and their respective affiliates in the Wireless business segment accounted for 32.4% and 13.0% of the Company's total revenues for the nine months ended September 30, 2009. Sales to one customer in the Wireless business segment accounted for 36.4% of the Company's total revenues for the nine months ended September 30, 2008.

*Geographical Information*

During the three and nine months ended September 30, 2009 and 2008, the Company operated in three geographic locations: the Americas, Asia Pacific, and Europe, the Middle East, and Africa ( EMEA ). Revenues, attributed to the geographic location of the customer's bill-to address, were as follows (in thousands):

|                | Three Months Ended           |           | Nine Months Ended            |           |
|----------------|------------------------------|-----------|------------------------------|-----------|
|                | September 30,<br>(unaudited) |           | September 30,<br>(unaudited) |           |
|                | 2009                         | 2008      | 2009                         | 2008      |
| Americas       | \$ 25,496                    | \$ 24,008 | \$ 70,881                    | \$ 64,521 |
| Asia Pacific   | 1,198                        | 1,314     | 3,183                        | 3,921     |
| EMEA           | 1,126                        | 1,319     | 3,530                        | 3,531     |
| Total Revenues | \$ 27,820                    | \$ 26,641 | \$ 77,594                    | \$ 71,973 |

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

**16. Recent Accounting Pronouncements**

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification<sup>TM</sup> 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. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the 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.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*. SFAS No. 167 addresses (1) the effects on certain provisions of Financial Accounting Standards Board Interpretation ( FIN ) No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, as a result of the elimination of the qualifying special-purpose entity concept in SFAS No. 166, *Accounting for Transfers of Financial Assets*, and (2) constituent concerns about the application of certain key provisions of FIN No. 46(R), including those in which the accounting and disclosures under the Interpretation do not always provide timely and useful information about an enterprise's involvement in a variable interest entity. This Statement shall be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company will adopt SFAS No. 167 on its effective date and does not expect its adoption to have an impact on its consolidated results of operations and financial condition.

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140*. SFAS No. 166 was issued to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. This Statement must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. This Statement must be applied to transfers occurring on or after the effective date. The Company will adopt SFAS No. 166 on its effective date and does not expect its adoption to have an impact on its consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141(R) (Revised 2007), *Business Combinations* which has since been superseded by the Business Combinations Topic of the FASB Accounting Standards Codification. The Topic is



to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations, resulting in more complete, comparable and relevant information for investors and other users of financial statements. The Topic requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. The Topic is effective as of the start of fiscal years beginning after December 15, 2008. Early adoption is not allowed. The Company has adopted this Topic but the impact will not be known until there is another business acquisition.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements* which has since been superseded by the Consolidation Topic of the FASB Accounting Standards Codification. This Topic improves the relevance, comparability, and transparency of financial information provided to investors by requiring all entities to report non-controlling (minority) interests in subsidiaries in the same way as equity in the consolidated financial statements. Moreover, it eliminates the diversity that currently exists in accounting for transactions between an entity and non-controlling interests by requiring they be treated as equity transactions. The Topic is effective as of the start of fiscal years beginning after December 15, 2008. Early adoption is not allowed. The Company has adopted this Topic and its adoption did not impact its consolidated results of operations and financial condition.

## 17. Commitments and Contingencies

### Leases

The Company leases its buildings under operating leases that expire on various dates through 2016. Future minimum annual lease payments under such leases as of September 30, 2009 are as follows (in thousands):

| <b>Year Ending December 31,</b> | <b>Operating</b> |
|---------------------------------|------------------|
| 2009-3 months                   | \$ 434           |
| 2010                            | 1,689            |
| 2011                            | 1,606            |
| 2012                            | 1,393            |
| 2013                            | 923              |
| 2014                            | 737              |
| Beyond                          | 1,081            |
| Total                           | \$ 7,863         |

Rent expense under operating leases for the three months ended September 30, 2009 and 2008 was \$0.5 million and \$0.4 million, respectively. Rent expense under operating leases for the nine months ended September 30, 2009 and 2008 was \$1.4 million and \$1.3 million, respectively.

## 18. Income Taxes

The Company accounts for income taxes as required by the Income Taxes Topic of the FASB Accounting Standards Codification. This Topic clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Topic also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our evaluation was performed for the tax years ended December 31, 2005, 2006, 2007, and 2008, the tax years which remain subject to examination by major tax jurisdictions as of September 30, 2009.

In the three and nine months ended September 30, 2009, we recorded income tax expense in the amount of \$2.3 million and \$4.2 million, respectively.

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. In the event we have received an assessment for interest and/or penalties, it has been classified in the financial statements as general and administrative expense.

In June 2008, the Internal Revenue Service began its examination of the Company's U.S. federal tax return for the period ended December 31, 2006. The examination is now complete and there were no adjustments.

## 19. Subsequent Events

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* which has since been superseded by the Subsequent Events Topic of the FASB Accounting Standards Codification. 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.

The Company has adopted this Topic. Subsequent events have been evaluated as of November 5, 2009 and no further disclosures were required and its adoption did not impact its consolidated results of operations and financial condition.

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.

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

*This report contains forward-looking statements regarding Smith Micro Software, Inc. ( we, us, our, Smith Micro, or the Company ) 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:*

*The duration and depth of the current economic slowdown and its effects on capital expenditures by our customers and their end users;*  
*our ability to predict consumer needs, introduce new products, gain broad market acceptance for such products and ramp up manufacturing in a timely manner;*  
*changes in demand for our products from our 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;*  
*the response of competitors, many of whom are bigger and better financed than us;*  
*our ability to successfully execute our business plan and control costs and expenses;*  
*our ability to protect our intellectual property and our ability to not infringe on the rights of others; and*  
*those additional factors which are listed under the section Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008.*

*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 SEC. We do not undertake any obligation to update these statements to reflect events or circumstances occurring after the date this report is filed.*

### Overview

Smith Micro Software, Inc. ( 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.

We develop mobility solutions that enable seamless broadband connectivity and next-generation multimedia and fixed-mobile convergence products over wireless networks. The Company's portfolio of mobility solutions include the QuickLink® family of client and server products that enable seamless broadband connectivity to manage wireless data communications for 3G and 4G WWAN, WiMAX and WiFi broadband wireless networks, and next generation multimedia products to manage content mobility and fixed-mobile convergence products for mobile devices and wireless networks. The Company also integrates device management and data compression solutions into both existing connectivity products and standalone product offerings.

The proliferation of broadband mobile wireless technologies is providing new opportunities for our products and services on a global basis. When these broadband wireless technologies EVDO, UMTS/HSPA, WiFi, and WiMAX are combined with new devices such as mobile phones, PCs, Netbooks, Smartphones, and Ultra-Mobile PCs, opportunities emerge for new communications software products. Our core technologies are designed to address these emerging mobile convergence opportunities.

We distribute our product lines and various third-party software products worldwide, directly and through our online stores, third-party wholesalers, retailers and value-added resellers.

We offer software products that operate on Windows, Mac, UNIX, Linux, Windows Mobile, Symbian, and Java platforms. The underlying design concept common across our products is our ability to improve the customer's experience and this philosophy is based on the combination of solid engineering and exceptional design that reinforces our brand's competitive differentiation and customer value. We have over 25 years of experience in design, creation and custom engineering services for software products. We create value by leveraging our business model to build new services and solutions that allow our customers to quickly enter a market with new product offerings that target their customer segments.

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.

### Results of Operations

The table below sets forth certain statements of operations data expressed as a percentage of revenues for the three and nine months ended September 30, 2009 and 2008. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

|                            | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|----------------------------|-------------------------------------|--------|------------------------------------|--------|
|                            | 2009                                | 2008   | 2009                               | 2008   |
| Revenues                   | 100.0%                              | 100.0% | 100.0%                             | 100.0% |
| Cost of revenues           | 12.7                                | 19.5   | 15.4                               | 21.9   |
| Gross profit               | 87.3                                | 80.5   | 84.6                               | 78.1   |
| Operating expenses:        |                                     |        |                                    |        |
| Selling and marketing      | 21.4                                | 23.5   | 23.7                               | 26.2   |
| Research and development   | 33.2                                | 30.8   | 33.6                               | 32.1   |
| General and administrative | 17.8                                | 18.5   | 18.0                               | 20.2   |
| Total operating expenses   | 72.4                                | 72.8   | 75.3                               | 78.5   |
| Operating income (loss)    | 14.9                                | 7.7    | 9.3                                | (0.4)  |
| Interest and other income  | 0.4                                 | 0.4    | 0.6                                | 0.7    |
| Profit before taxes        | 15.3                                | 8.1    | 9.9                                | 0.3    |
| Income tax expense         | 8.2                                 | 14.0   | 5.3                                | 3.1    |
| Net income (loss)          | 7.1%                                | (5.9)% | 4.6%                               | (2.8)% |

### 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. Substantially all of our operations are organized into two business units:

Wireless, which includes our connection manager solutions for the OEM and Enterprise channels, music, photo and video content management, and device management; and Productivity & Graphics, which includes retail sales of our compression and broad consumer-based software.

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

|                         | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                         | 2009                                | 2008      | 2009                               | 2008      |
| Wireless                | \$ 22,665                           | \$ 19,919 | \$ 63,295                          | \$ 52,911 |
| Productivity & Graphics | 4,986                               | 6,396     | 13,569                             | 18,101    |
| Corporate/Other         | 169                                 | 326       | 730                                | 961       |
| Total 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 |

Corporate/Other refers to the consulting portion of our services sector which has been de-emphasized and is no longer considered a strategic element of our future plans.

*Cost of revenues.* Cost of revenues consists of direct product costs, royalties, and the amortization of purchased intangibles and capitalized software.

*Selling and marketing.* Selling and marketing expenses consist primarily of personnel costs, advertising costs, sales commissions, trade show expenses, and the amortization of certain purchased intangibles. 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, and the amortization of acquired intangibles. We remain focused on the development and expansion of our technology, particularly our wireless, compression and multimedia software technologies.

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

*Interest and other income.* Interest and other income are directly related to our average cash and short term investment balances during the period and vary among periods. In June 2008, we changed our investment strategy to include short-term investments in equity and debt securities with maturity dates within three to 12 months. Our other excess cash is invested in short term marketable equity and debt securities classified as cash equivalents.

*Income tax expense.* The Company accounts for income taxes as required by the Income Taxes Topic of the FASB Accounting Standards Codification. 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. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized. Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements.

***Three Months Ended September 30, 2009 Compared to the Three Months Ended September 30, 2008***

*Revenues.* Revenues were \$27.8 million and \$26.6 million for the three months ended September 30, 2009 and 2008, respectively, representing an increase of \$1.2 million, or 4.4%. Wireless sales increased \$2.7 million, or 13.8%, primarily due to new connectivity and security product OEM licenses of \$5.2 million. These increases were partially offset by a \$2.5 million decrease in revenues primarily due to a change in how our multimedia products were merchandised by our primary music customers, which changed from higher revenue, lower margin music kits (including software, cable and ear buds) to downloadable software or a software-only CD, resulting in lower revenue per unit but a much higher margin per unit. Productivity & Graphics sales decreased \$1.4 million, or 22.0%, primarily due to the continued consumer economic downturn. Corporate/Other sales decreased \$0.1 million as we have de-emphasized this business.



*Cost of revenues.* Cost of revenues were \$3.5 million and \$5.2 million for the three months ended September 30, 2009 and 2008, respectively, representing a decrease of \$1.7 million, or 31.9%. Direct product costs decreased \$1.9 million primarily due to a shift in product mix and overhead cost reductions. The product mix was due to a decrease in sales of lower margin multimedia and productivity and graphics products and an increase of sales of higher margin OEM license products. Amortization of intangibles

increased from \$0.9 million to \$1.2 million, or \$0.3 million, due to several small acquisitions made in the fourth quarter of 2008. Stock-based compensation expense decreased \$0.1 million, from \$0.1 million to essentially zero.

*Gross profit.* Gross profit was \$24.3 million, or 87.3% of revenues for the three months ended September 30, 2009, an increase of \$2.8 million, or 13.2%, from \$21.5 million, or 80.5% of revenues for the three months ended September 30, 2008. The 6.8 percentage point increase in gross profit as a percentage of revenues was primarily due to improved product margins of 7.4 points as a result of the change in product mix mentioned above and overhead cost reductions, and lower stock-based compensation expense as a percentage of revenues of 0.3 points. These items were partially offset by higher amortization of intangibles due to several small acquisitions of 0.9 points.

*Selling and marketing.* Selling and marketing expenses were \$5.9 million and \$6.2 million for the three months ended September 30, 2009 and 2008, respectively, representing a decrease of \$0.3 million, or 4.9%. This decrease was primarily due to overall reduced spending in areas such as travel and other areas of \$0.2 million and stock-based compensation expense of \$0.1 million, decreasing from \$0.8 million to \$0.7 million. Amortization of intangible assets was \$0.6 million for both fiscal quarters ended September 30, 2009 and 2008.

*Research and development.* Research and development expenses were \$9.2 million and \$8.2 million for the three months ended September 30, 2009 and 2008, respectively, representing an increase of \$1.0 million, or 12.6%. This increase was primarily due to increased personnel and recruiting costs associated with new hired headcount of \$1.4 million to support our product initiatives and contract wins. This increase was partially offset by lower stock-based compensation expense which decreased by \$0.2 million, from \$0.9 million to \$0.7 million. Amortization of purchased technologies decreased by \$0.2 million, from \$0.5 million to \$0.3 million.

*General and administrative.* General and administrative expenses were \$5.0 million and \$4.9 million for the three months ended September 30, 2009 and 2008, respectively, representing an increase of \$0.1 million, or 0.5%. Expense increases were primarily due to increased space and occupancy and infrastructure costs of \$0.4 million, higher salaries and bonuses of \$0.1 million, and legal and accounting fees incurred with our acquisition of Core Mobility of \$0.1 million. These cost increases were partially offset by lower stock-based compensation expense which decreased from \$1.5 million to \$1.0 million, respectively, for the fiscal quarters ended September 30, 2008 and 2009.

*Interest and other income.* Interest and other income was \$0.1 million for both fiscal quarters ended September 30, 2009 and 2008.

*Income tax provision.* We recorded an income tax expense for the three months ended September 30, 2009 in the amount of \$2.3 million. The high effective tax rate is due to incentive stock option compensation book expense which is a permanent difference to the taxable income. We recorded an income tax expense for the three months ended September 30, 2008 in the amount of \$3.7 million as a result of reversing tax benefits recorded in the prior quarters. This was a result of using the effective tax rate calculated based on the year-to-date financials ( cut-off method ) because we believed this tax rate was more accurate than the annual effective tax rate.

#### ***Nine Months Ended September 30, 2009 Compared to the Nine Months Ended September 30, 2008***

*Revenues.* Revenues were \$77.6 million and \$72.0 million for the nine months ended September 30, 2009 and 2008, respectively, representing an increase of \$5.6 million, or 7.8%. Wireless sales increased \$10.4 million, or 19.6%, primarily due to new connectivity and security product OEM licenses of \$19.9 million. These increases were partially offset by a \$9.5 million decrease in revenues primarily due to a change in how our multimedia products were merchandised by our primary music customers, which changed from higher revenue, lower margin music kits (including software, cable and ear buds) to downloadable software or a software-only CD, resulting in lower revenue per unit but a much higher margin per unit. Productivity & Graphics sales decreased \$4.5 million, or 25.0%, primarily due to the continued consumer economic downturn. Corporate/Other sales decreased \$0.3 million as we have de-emphasized this business.

*Cost of revenues.* Cost of revenues were \$12.0 million and \$15.8 million for the nine months ended September 30, 2009 and 2008, respectively, representing a decrease of \$3.8 million, or 24.0%. Direct product costs decreased \$4.4 million primarily due to a shift in product mix and overhead cost reductions. The product mix was due to a decrease in sales of lower margin multimedia and productivity and graphics products and an increase of sales of higher margin OEM license products. Amortization of intangibles increased from \$2.7 million to \$3.5 million, or \$0.8 million, due to several small acquisitions made in the fourth quarter of 2008. Stock-based compensation expense

decreased from \$0.3 million to \$0.1 million, or \$0.2 million.

*Gross profit.* Gross profit was \$65.6 million, or 84.6% of revenues for the nine months ended September 30, 2009, an increase of \$9.4 million, or 16.7%, from \$56.2 million, or 78.1% of revenues for the nine months ended September 30, 2008. The 6.5

percentage point increase in gross profit as a percentage of revenues was primarily due to improved product margins of 7.0 points as a result of the change in product mix mentioned above and overhead cost reductions, and lower stock-based compensation expense as a percentage of revenues of 0.3 points. These items were partially offset by higher amortization of intangibles due to several small acquisitions of 0.8 points.

*Selling and marketing.* Selling and marketing expenses were \$18.4 million and \$18.8 million for the nine months ended September 30, 2009 and 2008, respectively, representing a decrease of \$0.4 million, or 2.4%. This decrease was primarily due to a lower stock-based compensation expense of \$0.8 million, decreasing from \$2.9 million to \$2.1 million. This decrease was also due to reduced spending in areas such as travel and trade shows of \$0.2 million. These decreases were partially offset by costs associated with headcount increases of \$0.5 million and higher amortization of intangibles of \$0.1 million, which increased from \$1.8 million to \$1.9 million.

*Research and development.* Research and development expenses were \$26.1 million and \$23.1 million for the nine months ended September 30, 2009 and 2008, respectively, representing an increase of \$3.0 million, or 12.7%. This increase was primarily due to increased personnel, recruiting, and overhead costs associated with increased headcount of \$4.3 million to support our product initiatives and contract wins. This increase was partially offset by lower consulting costs of \$0.6 million as these temporary resources were replaced by full-time employees, lower stock-based compensation expense which decreased from \$2.6 million to \$2.0 million, or \$0.6 million, and lower amortization of purchased technologies which decreased from \$1.1 million to \$1.0 million, or \$0.1 million.

*General and administrative.* General and administrative expenses were \$14.0 million and \$14.6 million for the nine months ended September 30, 2009 and 2008, respectively, representing a decrease of \$0.6 million, or 4.1%. Expense decreases were primarily due to lower stock-based compensation expense which decreased from \$4.2 million to \$3.2 million, or \$1.0 million, and overall reduced spending in other areas of \$0.4 million. These expense decreases were partially offset by increased space and occupancy and infrastructure costs of \$0.7 million and legal and accounting fees incurred with our acquisition of Core Mobility of \$0.1 million.

*Interest and other income.* Interest and other income was \$0.5 million for both nine months ended September 30, 2009 and 2008.

*Income tax provision.* We recorded an income tax expense for the nine months ended September 30, 2009 in the amount of \$4.2 million. The high effective tax rate is due to incentive stock option compensation book expense which is a permanent difference to the taxable income. We recorded an income tax provision for the nine months ended September 30, 2008 in the amount of \$2.3 million as a result of our pre-tax operating profit for the period and the relatively large amount of incentive stock option expense which is not deductible for tax purposes.

### **Liquidity and Capital Resources**

At September 30, 2009, we had \$48.5 million in cash and cash equivalents and short-term investments and \$63.4 million of working capital. On January 4, 2008, we acquired the Mobile Solutions Group of PCTEL at a cost of \$59.7 million in cash plus \$1.2 million of legal and banking fees which were paid through September 30, 2008. In October and November, we will payout approximately \$7.0 million in cash in connection with our acquisition of Core Mobility. We currently have no other significant capital commitments, and currently anticipate that capital expenditures will not vary significantly from recent periods. We believe that our existing cash, cash equivalents, and short-term investment balances and cash flow from operations will be sufficient to finance our working capital and capital expenditure requirements through at least the next twelve months. We may require additional funds to support our working capital requirements or for other purposes and may seek to raise additional funds through public or private equity or debt financing or from other sources. If additional financing is needed, we cannot assure that such financing will be available to us at commercially reasonable terms or at all.

#### *Operating activities*

Net cash provided by operating activities was \$13.6 million for the nine months ended September 30, 2009. Our net cash provided by operating activities resulted from net income of \$3.5 million adjusted for non-cash expenses including depreciation and amortization of \$7.6 million, stock-based compensation of \$6.5 million, other non-cash expenses of \$1.4 million, and increases of current liabilities net of other assets of \$0.8 million. The primary use of cash affecting operating cash flow was an increase in accounts receivable of \$6.0 million and an increase of inventory net of other assets of \$0.2 million. Net cash provided by operating activities was \$8.5 million in the nine months

ended September 30, 2008. The primary sources of operating cash were adjustments for non-cash expenses including stock-based compensation of \$9.1 million, depreciation and amortization of \$6.5 million, other non-cash expenses of \$0.9 million, a decrease in deferred income taxes of \$1.4 million, and a decrease in other net current assets of \$0.7 million. The primary use of cash affecting operating cash flow was an increase in accounts receivable of \$8.0 million and the net loss of \$2.1 million. The increase in accounts receivable was due to the timing of invoicing during the period and an increase in revenue from the prior quarter.

*Investing activities*

During the nine months ended September 30, 2009, we used \$13.8 million in investing activities due to investing in short-term investments of \$9.8 million and capital expenditures for leasehold improvements, a new phone system, a new ERP system, and other computer equipment of \$4.0 million. During the nine months ended September 30, 2008, we used \$71.3 million in investing activities due to the acquisition of the Mobility Solutions Group of PCTEL of \$60.9 million, investing in short-term investments \$6.3 million, and capital expenditures, primarily leasehold improvements, of \$3.2 million, and other acquisition-related cost adjustments of \$0.9 million.

*Financing activities*

We received \$2.4 million in cash during the nine months ended September 30, 2009; \$1.6 million from the exercise of stock options and \$0.8 million for tax benefits from stock-based compensation. We received \$0.2 million in cash during the nine months ended September 30, 2008 from the exercise of stock options and tax benefits from stock-based compensation.

*Contractual obligations and commercial commitments*

As of September 30, 2009 we had no debt. The following table summarizes our contractual obligations as of September 30, 2009 (in thousands):

|                                 | Total           | Payments due by period |                 |                 | More than 5 years |
|---------------------------------|-----------------|------------------------|-----------------|-----------------|-------------------|
|                                 |                 | 1 year or less         | 1-3 years       | 3-5 years       |                   |
| <b>Contractual obligations:</b> |                 |                        |                 |                 |                   |
| Operating Lease Obligations     | \$ 7,863        | \$ 1,699               | \$ 3,180        | \$ 1,718        | \$ 1,266          |
| Purchase Obligations            | 1,342           | 1,342                  |                 |                 |                   |
| <b>Total</b>                    | <b>\$ 9,205</b> | <b>\$ 3,041</b>        | <b>\$ 3,180</b> | <b>\$ 1,718</b> | <b>\$ 1,266</b>   |

During our normal course of business, we have made certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These include: intellectual property indemnities to our customers and licensees in connection with the use, sale and/or license of our products; indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease; indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct; indemnities involving the accuracy of representations and warranties in certain contracts; and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware. In addition, we have made contractual commitments to employees providing for severance payments upon the occurrence of certain prescribed events. 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 40,000 square feet of space pursuant to leases that expires May 31, 2016. We lease approximately 14,400 square feet in Chicago, Illinois under a lease that expires August 31, 2012. We lease approximately 13,300 square feet in Watsonville, California under a lease that expires September 30, 2013. We lease approximately 7,300 square feet in Herndon, Virginia under a lease that expires November 30, 2009. Internationally, we lease space in Stockholm, Sweden; Belgrade, Serbia; Oslo, Norway; and Vancouver, Canada. These leases are for one to three-year terms.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of results of operations, financial condition and liquidity are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may materially differ from these estimates

under different assumptions or conditions. On an on-going basis, we review our estimates to ensure that the estimates appropriately reflect changes in our business or new information as it becomes available.

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

*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 collectibility is probable as required by the Software-Revenue Recognition Topic of the FASB Accounting Standards Codification. We recognize revenues from sales of our software to OEM customers or end users as completed products are shipped and titles passes; or from royalties generated as authorized customers duplicate our software, if the other requirements are met. If the requirements are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. Returns from OEM customers are limited to defective goods or goods shipped in error. Historically, OEM customer returns have not exceeded the very nominal estimates and reserves. 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. Within the Productivity & Graphics group certain revenues are booked net of revenue sharing payments. 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 multiple element agreements, vendor specific objective evidence of fair value for all contract elements is reviewed and the timing of the individual element revenue streams is determined and recognized as required. Sales directly to end-users are recognized upon delivery. 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*

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 the Software-Revenue Recognition Topic of the FASB Accounting Standards Codification. We track incentives by program and use historical redemption rates to estimate the cost of customer incentives. Total sales incentives were \$0.7 and \$0.6 million for the nine months ended September 30, 2009 and 2008, 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 September 30, 2009, software has been substantially completed concurrently with the establishment of technological feasibility; accordingly, no costs have been capitalized to date.

*Capitalized Software and Amortization*



We capitalize internally developed software and software purchased from third parties if the related software product under development has reached technological feasibility or if there are alternative future uses for the purchased software as required by the Software-Costs of Software to be Sold, Leased, or Marketed Topic of the FASB Accounting Standards Codification. These costs are amortized on a product-by-product basis, typically over an estimated life of five to seven years, using the larger of the amount

calculated using the straight-line method or the amount calculated using the ratio between current period gross revenues and the total of current period gross revenues and estimated future gross revenues. At each balance sheet date, we evaluate on a product-by-product basis the unamortized capitalized cost of computer software compared to the net realizable value of that product. The amount by which the unamortized capitalized costs of a computer software product exceed its net realizable value is written off.

*Intangible Assets and Amortization*

Amortization expense related to other intangibles acquired in previous acquisitions is calculated on a straight line basis over various useful lives.

*Impairment or Disposal of Long Lived Assets*

Long-lived assets to be held are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. They are tested for recoverability using undiscounted cash flows to determine whether or not impairment to such value has occurred as required by the Property, Plant, and Equipment Topic of the FASB Accounting Standards Codification. The Company has determined that there was no impairment at September 30, 2009.

*Valuation of Goodwill and Intangible Assets*

The Company accounts for goodwill and intangible assets as required by the Intangibles-Goodwill and Other Topic of the FASB Accounting Standards Codification. This statement requires us to periodically assess the impairment of our goodwill and intangible assets, which requires us to make assumptions and judgments regarding the carrying value of these assets. These assets are considered to be impaired if we determine that their carrying value may not be recoverable based upon our assessment of the following events or changes in circumstances:

a determination that the carrying value of such assets cannot be recovered through undiscounted cash flows;

loss of legal ownership or title to the assets;

significant changes in our strategic business objectives and utilization of the assets; or

the impact of significant negative industry or economic trends.

If the intangible assets are considered to be impaired, the impairment we recognize is the amount by which the carrying value of the intangible assets exceeds the fair value of the intangible assets. In addition, we base the useful lives and the related amortization expense on our estimate of the useful life of the intangible assets. Due to the numerous variables associated with our judgments and assumptions relating to the carrying value of our intangible assets and the effects of changes in circumstances affecting these valuations, both the precision and reliability of the resulting estimates are subject to uncertainty, and as additional information becomes known, we may change our estimate, in which case, the likelihood of a material change in our reported results would increase.

*Deferred Income Taxes*

We account for income taxes as required by the Income Taxes Topic of the FASB Accounting Standards Codification. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in our financial statements or tax returns. The measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and the tax bases of our 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. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized. The Company's net deferred tax assets were not reduced by a tax valuation allowance at September 30, 2009. Management evaluated the positive and negative evidence in determining the realizability of the net deferred tax assets at September 30, 2009 and concluded it is more likely than not that the Company should realize its net deferred tax assets through future operating results and the reversal of taxable temporary differences.

*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.

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

#### *Interest Rate Risk*

Our financial instruments include cash and cash equivalents, and short-term investments. At September 30, 2009, the carrying values of our financial instruments approximated fair values based on current market prices and rates.

#### *Foreign Currency Risk*

While a majority of our business is denominated in U.S. dollars, we do occasionally invoice in foreign currencies. For the three months ended September 30, 2009 and 2008, our revenues denominated in foreign currencies were \$0.5 million and \$0.7 million, respectively. For the nine months ended September 30, 2009 and 2008, our revenues denominated in foreign currencies were \$1.2 million and \$1.4 million, respectively. Fluctuations in the rate of exchange between the U.S. dollar and certain other currencies may affect our results of operations and period-to-period comparisons of our operating results. We do not currently engage in hedging or similar transactions to reduce these risks. The operational expenses of our foreign entities reduce the currency exposure we have because our foreign currency revenues are offset in part by expenses payable in foreign currencies. As such, we do not believe we have a material exposure to foreign currency rate fluctuations at this time.

### **Item 4. Controls and Procedures**

#### *Evaluation of disclosure controls and procedures*

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 ( "Exchange Act" )) as of September 30, 2009. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have determined that as of September 30, 2009, our disclosure controls and procedures were effective to ensure that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

#### *Management's responsibility for financial statements*

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

The Audit Committee of the Board of Directors, which is composed solely of independent directors, meets regularly with our independent registered public accounting firm, SingerLewak LLP, and representatives of management to review accounting, financial reporting, internal control and audit matters, as well as the nature and extent of the audit effort. The Audit Committee is responsible for the engagement of the independent auditors. The

independent auditors have free access to the Audit Committee.

*Changes in internal control over financial reporting*

There have been no changes in our internal control over financial reporting during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

From time to time we may be party to litigation incidental to our business, none of which is expected to have a material adverse effect on us.

### Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for our fiscal year ended December 31, 2008. The risks discussed in our Annual Report on Form 10-K could materially affect our business, financial condition and future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or operating results.

### Item 4. Submission of Matters to a Vote of Security Holders

An Annual Meeting of the Stockholders of the Company was held on August 24, 2009. At the Annual Meeting, the Stockholders voted as follows:

The Stockholders elected Thomas G. Campbell (with 19,668,734 votes for and 7,964,805 withheld) and Ted L. Hoffman (with 20,985,726 votes for and 6,647,813 withheld) as directors, to hold office until the 2011 Annual Meeting, or until their successors are elected and qualified.

In addition to Messrs. Campbell and Hoffman, the following directors will continue to hold office: William W. Smith, Jr., William C. Keiper, Samuel Gulko, and Gregory J. Szabo.

The Stockholders elected to ratify the appointment of SingerLewak LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2009 (with 24,528,135 shares for, 173,892 shares against and 48,316 shares abstaining).

### Item 6. Exhibits

2.1 Agreement and Plan of Merger, dated September 9, 2009, by and among Smith Micro Software, Inc., Mobility Acquisition Corp., Core Mobility, Inc., Konstantin Othmer, as stockholders' agent, and the founders of Core Mobility. Certain schedules and exhibits referenced in the Agreement and Plan of Merger have been omitted in accordance with Item 601(b)(2) of Regulation S-K. A copy of any omitted schedule and/or exhibit will be furnished supplementally to the Securities and Exchange Commission upon request.

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

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

SMITH MICRO SOFTWARE, INC.

November 5, 2009

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

November 5, 2009

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

**Index to Exhibits**

**Item 6. Exhibits**

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- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
  
- 32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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