

SMITH MICRO SOFTWARE INC
Form 10-Q
October 31, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

Commission file number 01-35525

SMITH MICRO SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

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

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

51 COLUMBIA

ALISO VIEJO, CA 92656

(Address of principal executive offices, including zip code)

(949) 362-5800

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was 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 (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 24, 2014 there were 45,058,093 shares of common stock outstanding.

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September 30, 2014
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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****SMITH MICRO SOFTWARE, INC.****CONSOLIDATED BALANCE SHEETS****(in thousands, except share and par value data)**

	September 30, 2014 (unaudited)	December 31, 2013 (audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 10,493	\$ 11,763
Short-term investments	2,201	3,078
Accounts receivable, net of allowances for doubtful accounts and other adjustments of \$603 (2014) and \$617 (2013)	7,355	7,563
Income tax receivable	699	699
Inventories, net of reserves for excess and obsolete inventory of \$237 (2014) and \$301 (2013)	165	167
Prepaid expenses and other current assets	1,128	871
Deferred tax asset	152	152
Total current assets	22,193	24,293
Equipment and improvements, net	4,697	7,023
Other assets	205	222
Total assets	\$ 27,095	\$ 31,538
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 2,145	\$ 1,632
Accrued liabilities	6,079	7,734
Deferred revenue	731	464
Total current liabilities	8,955	9,830
Non-current liabilities:		
Deferred rent and other long-term liabilities	3,736	3,383
Deferred tax liability	152	154
Total non-current liabilities	3,888	3,537
Commitments and contingencies		
Stockholders equity:		

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Preferred stock, par value \$0.001 per share; 5,000,000 shares authorized; none issued or outstanding

Common stock, par value \$0.001 per share; 100,000,000 shares authorized; 45,058,093 and 36,994,318 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively	45	37
Additional paid-in capital	222,696	214,619
Accumulated comprehensive deficit	(208,489)	(196,485)
Total stockholders' equity	14,252	18,171
Total liabilities and stockholders' equity	\$ 27,095	\$ 31,538

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues	\$ 9,448	\$ 8,746	\$ 26,425	\$ 30,832
Cost of revenues	2,201	2,492	7,072	7,337
Gross profit	7,247	6,254	19,353	23,495
Operating expenses:				
Selling and marketing	2,139	3,705	7,471	12,655
Research and development	3,188	5,355	11,046	17,191
General and administrative	3,064	4,572	10,360	14,376
Restructuring expense		5,602	2,435	5,602
Total operating expenses	8,391	19,234	31,312	49,824
Operating loss	(1,144)	(12,980)	(11,959)	(26,329)
Interest and other income (expense), net	(3)	7	(5)	27
Loss before provision for income taxes	(1,147)	(12,973)	(11,964)	(26,302)
Provision for income tax expense (benefit)	(5)	76	40	149
Net loss	(1,142)	(13,049)	(12,004)	(26,451)
Other comprehensive income (loss), before tax:				
Unrealized holding gains (losses) on available-for-sale securities	(1)	3		4
Income tax expense related to items of other comprehensive income (expense)				
Other comprehensive income (expense), net of tax	(1)	3		4
Comprehensive loss	\$ (1,143)	\$ (13,046)	\$ (12,004)	\$ (26,447)
Net loss per share:				
Basic and diluted	\$ (0.03)	\$ (0.35)	\$ (0.31)	\$ (0.72)
Weighted average shares outstanding:				
Basic and diluted	41,225	37,036	39,165	36,967

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See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(in thousands)

	Common stock		Additional	Accumulated	Total
	Shares	Amount	paid-in capital	comprehensive deficit	
BALANCE, December 31, 2013	36,994	\$ 37	\$ 214,619	\$ (196,485)	\$ 18,171
Exercise of common stock options	4		6		6
Non cash compensation recognized on stock options and ESPP			112		112
Restricted stock grants, net of cancellations	1,411	1	2,982		2,983
Cancellation of shares for payment of withholding tax	(224)		(328)		(328)
Employee stock purchase plan (ESPP)	27		21		21
Issuance of common stock in a private placement	6,846	7	5,284		5,291
Comprehensive loss				(12,004)	(12,004)
BALANCE, September 30, 2014 (unaudited)	45,058	\$ 45	\$ 222,696	\$ (208,489)	\$ 14,252

See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30,	
	2014	2013
	(unaudited)	(unaudited)
Operating activities:		
Net loss	\$ (12,004)	\$ (26,451)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,375	3,110
Long-lived assets write-off due to restructuring		1,011
Provision for doubtful accounts and other adjustments to accounts receivable	347	459
Provision for excess and obsolete inventory	38	62
Non-cash compensation related to stock options, ESPP and restricted stock	3,095	2,747
Deferred income taxes	(2)	
Change in operating accounts:		
Accounts receivable	(139)	1,479
Income tax receivable		1
Inventories	(36)	(48)
Prepaid expenses and other assets	(240)	(335)
Accounts payable and accrued liabilities	(1,082)	4,010
Deferred revenue	267	593
Net cash used in operating activities	(7,381)	(13,362)
Investing activities:		
Capital expenditures	(84)	(820)
Sales of short-term investments	877	6,136
Net cash provided by investing activities	793	5,316
Financing activities:		
Cash from issuance of common stock, net of offering costs	5,291	
Cash received from stock sale for employee stock purchase plan	21	36
Cash received from exercise of stock options	6	
Net cash provided by financing activities	5,318	36
Net decrease in cash and cash equivalents	(1,270)	(8,010)
Cash and cash equivalents, beginning of period	11,763	18,873
Cash and cash equivalents, end of period	\$ 10,493	\$ 10,863

Supplemental disclosures of cash flow information:

Cash paid for income taxes	\$	61	\$	163
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See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.

Notes to the Consolidated Financial Statements

1. The Company

Smith Micro Software, Inc. (we, us, our, Smith Micro, or the Company) provides software and services that simulate, secure and enhance the mobile experience. The Company's portfolio of wireless solutions includes a wide range of client and server applications that manage devices, communications and network connectivity for end-users as well as Machine-to-Machine (M2M) endpoints. Our primary customers are the world's leading wireless service providers, mobile device and chipset manufacturers, and enterprise businesses. In addition to our wireless and mobility software, Smith Micro offers personal productivity, graphics and animation products distributed through a variety of consumer channels worldwide.

2. Basis of Presentation

The accompanying interim consolidated balance sheet and statement of stockholders' equity as of September 30, 2014, and the related statements of comprehensive loss for the three and nine months ended September 30, 2014 and 2013 and the related statements of cash flows for the nine months ended September 30, 2014 and 2013 are unaudited. The unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted.

In the opinion of management, the accompanying unaudited consolidated financial statements for the periods presented reflect all adjustments, which are normal and recurring, necessary to fairly state the financial position, results of operations and cash flows. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 filed with the SEC on March 7, 2014.

Intercompany balances and transactions have been eliminated in consolidation.

Operating results for the three and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2014.

The accompanying interim consolidated financial statements have been prepared assuming that the Company will continue as a going concern. A going concern basis of accounting contemplates the recovery of the Company's assets and the satisfaction of its liabilities in the normal course of business. Based on the Company's current financial revenue projections, our reduced cost structure as a result of our 2014 restructuring (see Note 16), and the proceeds of \$5.3 million net (see Note 14) received from the recent sell of our common stock in a private placement, management believes that its existing cash, cash equivalents and short-term investment of \$12.7 million will be sufficient to fund the Company's operations through at least the next twelve months.

3. Recent Accounting Pronouncements

In August 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements-Going Concern (Subtopic (205-40))*. The Update provides U.S. GAAP guidance on management's responsibility in evaluating whether there is substantial doubt about a company's ability to continue as a going concern

and about related footnote disclosures. For each reporting period, management will be required to evaluate whether there are conditions or events that raise substantial doubt about a company's ability to continue as a going concern within one year from the date the financial statements are issued. The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. We are currently evaluating the impact of this guidance on our consolidated financial statements.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(unaudited, in thousands, except per share amounts)			
Numerator:				
Net loss available to stockholders	\$ (1,142)	\$ (13,049)	\$ (12,004)	\$ (26,451)
Denominator:				
Weighted average shares outstanding - basic	41,225	37,036	39,165	36,967
Potential common shares - options (treasury stock method)				
Weighted average shares outstanding - diluted	41,225	37,036	39,165	36,967
Shares excluded (anti-dilutive)	2		13	3
Shares excluded due to an exercise price greater than weighted average stock price for the period	1,596	2,271	1,536	2,261
Net loss per share:				
Basic	(\$ 0.03)	(\$ 0.35)	(\$ 0.31)	(\$ 0.72)
Diluted	(\$ 0.03)	(\$ 0.35)	(\$ 0.31)	(\$ 0.72)

5. Stock-Based Compensation*Stock Plans*

During the nine months ended September 30, 2014, the Company granted options to purchase 45,000 shares of common stock and 1.6 million shares of restricted stock, with a total value of \$2.9 million. This cost will be amortized ratably over a period of 12 to 48 months.

As of September 30, 2014 there were 2.0 million shares available for future grants under the 2005 Plan.

Employee Stock Purchase Plan

The Company's most recent six-month offering period ended September 30, 2014 and resulted in 14,000 shares being purchased/granted at a fair value of \$0.83 per share.

Stock Compensation

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(unaudited)		(unaudited)	
Cost of revenues	\$ 2	\$ 6	\$ 10	\$ 17
Selling and marketing	63	138	201	698
Research and development	160	205	491	622
General and administrative	307	472	1,120	1,410
Restructuring expense			1,273	
Total non-cash stock compensation expense	\$ 532	\$ 821	\$ 3,095	\$ 2,747

Total share-based compensation for each quarter included cash payments of income taxes related to grants of restricted stock which was de minimis for both of the three month periods ended September 30, 2014 and 2013, respectively. The cash payments of income taxes related to grants of restricted stock totaled \$0.1 million and \$0.3 million for the nine month periods ended September 30, 2014 and 2013, respectively.

6. Fair Value of Financial Instruments

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

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

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

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

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

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

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

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

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

7. 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, 2014 and December 31, 2013, bank balances totaling approximately \$10.2 million and \$11.6 million, respectively, were uninsured.

Table of Contents**8. Short-Term Investments**

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

	September 30, 2014			December 31, 2013		
	Amortized cost basis	Gross unrealized gain(loss)	Fair value	Amortized cost basis	Gross unrealized gain(loss)	Fair value
Corporate notes, bonds and paper	\$ 1,002	\$	\$ 1,002	\$ 919	\$ (1)	\$ 918
Government securities/money market	1,200	(1)	1,199	2,160		2,160
Total	\$ 2,202	\$ (1)	\$ 2,201	\$ 3,079	\$ (1)	\$ 3,078

Realized gains were zero for both three and nine months ended September 30, 2014 and 2013.

9. Accounts Receivable

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

10. Inventories

Inventories consist principally of compact disks (CDs), boxes and manuals and are stated at the lower of cost (determined by the first-in, first-out method) or market. The Company regularly reviews its inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on management's forecast of product demand and production requirements. At September 30, 2014, our net inventory balance consisted of approximately \$0.1 million of components and \$0.1 million of finished goods.

11. 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.

12. Segment, Customer Concentration and Geographical Information

Segment Information

Public companies are required to report financial and descriptive information about their reportable operating segments as required by FASB ASC Topic No. 280, Segment Reporting. The Company has two primary business units based on how management internally evaluates separate financial information, business activities and management responsibility. Wireless includes our QuickLink[®], NetWise[®] and CommSuite[®] family of products. Productivity & Graphics includes our consumer-based products: Poser[®], Anime Studio[®], Manga Studio[®], MotionArtist[®] and StuffIt[®].

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(unaudited)		(unaudited)	
Wireless	\$ 8,355	\$ 7,243	\$ 22,205	\$ 25,989
Productivity & Graphics	1,093	1,503	4,220	4,843
Total revenues	\$ 9,448	\$ 8,746	\$ 26,425	\$ 30,832

Customer Concentration Information

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Wireless:				
Sprint (& affiliates)	67.1%	61.5%	67.3%	55.6%
Verizon Wireless (& affiliates)	8.2%	9.8%	7.4%	14.9%
Productivity & Graphics:				
FastSpring	10.0%	13.6%	11.8%	11.9%

These three customers listed above comprised 94% and 88% of our accounts receivable at September 30, 2014 and 2013, respectively.

Geographical Information

During the three and nine months ended September 30, 2014 and 2013, the Company operated in three geographic locations; the Americas, EMEA (Europe, the Middle East, and Africa) and Asia Pacific. Revenues, attributed to the geographic location of the customer's bill-to address, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(unaudited)		(unaudited)	
Americas	\$ 8,859	\$ 8,318	\$ 25,447	\$ 29,340
EMEA	541	166	719	788
Asia Pacific	48	262	259	704
Total Revenues	\$ 9,448	\$ 8,746	\$ 26,425	\$ 30,832

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

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The Company leases its buildings under operating leases that expire on various dates through 2022. Future minimum annual lease payments under such leases as of September 30, 2014 are as follows (in thousands):

Year Ending December 31,	Operating
2014-3 months	\$ 592
2015	2,188
2016	1,887
2017	1,535
2018	1,534
2019	1,508
Beyond	3,083
Total	\$ 12,327

As of September 30, 2014, \$5.8 million of the remaining lease commitments expense has been accrued as part of the 2013 Restructuring Plan, partially offset by future estimated sublease income of \$3.1 million.

Rent expense under operating leases was \$0.3 million and \$0.6 million the three months ended September 30, 2014 and 2013, respectively. Rent expense under operating leases was \$1.0 million and \$1.8 million for the nine months ended September 30, 2014 and 2013, respectively.

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

Pennsylvania Opportunity Grant Program

On September 26, 2011, we received \$1.0 million from the State of Pennsylvania to help fund our agreement to start-up a new facility. The grant carried with it an obligation, or commitment, to employ at least 232 people within a three-year time period that ended on December 31, 2013. We received an extension of time to meet this employment commitment. The new deadline is now February 28, 2015. This grant contains conditions that would require us to return a pro-rata amount of the monies received if we fail to meet these conditions. As such, the monies have been recorded as a liability in the accrued liabilities line item on the balance sheet until we are irrevocably entitled to retain the monies, or until it is determined that we need to return a portion or all of the monies received.

Litigation

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

Other Contingent Contractual Obligations

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

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14. Equity Transactions

On August 15, 2014, the Company entered into a common stock purchase agreement with a number of accredited investors (Investors) in a private placement pursuant to which the Company issued and sold to the Investors 6,845,830 shares of its common stock at a price per share of \$0.816. The transaction closed on August 20, 2014 and the Company realized gross proceeds of \$5.6 million before deducting commissions and other expenses. Offering costs related to the transaction totaled \$0.3 million, comprised of \$0.2 million of commissions and \$0.1 million of legal and other expenses, resulting in net proceeds of \$5.3 million. The Company filed a registration statement with the SEC providing for the resale of the shares of Common Stock issued pursuant to the Purchase Agreement. The registration statement became effective on September 25, 2014.

15. Income Taxes

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

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

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. A significant factor in the Company's assessment is that the Company has been in a three-year historical cumulative loss as of the end of fiscal year 2013. These facts, combined with uncertain near-term market and economic conditions, reduced the Company's ability to rely on projections of future taxable income in assessing the realizability of its deferred tax assets.

After a review of the four sources of taxable income as of December 31, 2013 (as described above), and after consideration of the Company's continuing cumulative loss position as of December 31, 2013, the Company will continue to reserve its U.S.-based deferred tax amounts, which total \$72.4 million, as of December 31, 2013.

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

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

16. Restructuring Expenses

2014 Restructuring

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

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

	December 31, 2013			September 30, 2014	
	Balance	Provision-net	Usage	Balance	
One-time employee termination benefits	\$	\$ 1,697	\$ (1,696)	\$	1
Fixed asset write-offs, transition travel, other		104	(15)		89
Total	\$	\$ 1,801	\$ (1,711)	\$	90

2013 Restructuring

In July 2013, the Board of Directors approved a plan of restructuring intended to bring the Company's operating expenses better in line with revenues. The restructuring plan involved a realignment of organizational structures, facility consolidations/closures and headcount reductions of approximately 26% of the Company's worldwide workforce. The restructuring plan has been implemented resulting in annualized savings of approximately \$16.0 million.

The restructuring plan resulted in special charges totaling \$5.6 million recorded during the three month period ended September 30, 2013. These charges were for lease/rental terminations of \$3.3 million, severance costs for affected employees of \$1.1 million, equipment and improvements write-offs as a result of our lease/rental terminations of \$1.0 million and other related costs of \$0.2 million. All are cash expenditures except for the equipment and improvements write-offs.

During the three month period ended June 30, 2014, we updated our assumptions related to subleases of our facility consolidations and closures and took an additional restructuring charge of \$0.6 million.

Following is the activity in our restructuring liability account through the period ended September 30, 2014 (in thousands).

	December 31, 2013			September 30, 2014	
	Balance	Provision-net	Usage	Balance	
One-time employee termination benefits	\$ 215	\$ (194)	\$ (21)	\$	
Lease/rental terminations	3,115	818	(932)		3,001
Fixed asset write-offs, transition travel, other	38	15	(53)		
Total	\$ 3,368	\$ 639	\$ (1,006)	\$	3,001

2012 Restructuring

We undertook a restructuring in the fiscal year 2012. Following is the activity in our restructuring liability account through the period ended September 30, 2014 (in thousands).

	December 31, 2013		Usage	September 30, 2014	
	Balance	Provision-net		Balance	
One-time employee termination benefits	\$ 4	\$ (4)	\$	\$	
Total	\$ 4	\$ (4)	\$	\$	

For all of these restructuring liabilities, those to be paid within 12 months are included in the accrued liabilities line item on the balance sheet and total \$1.1 million. \$2.0 million of restructuring is included in the deferred rent and other long-term liabilities line item on the balance sheet.

17. Subsequent Events

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

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NASDAQ Letter

On October 23, 2014, we received a written notification from the NASDAQ Stock Market LLC notifying the Company that it fails to comply with Nasdaq's Marketplace Rule 5450(a)(1) (the "Rule") because the bid price for the Company's common stock over the last 30 consecutive business days has closed below the minimum \$1.00 per share requirement for continued listing. The notification has no immediate effect on the listing of the Company's common stock.

In accordance with NASDAQ's Marketplace Rule 5810(c)(3)(A), the Company has a period of 180 calendar days, or until April 21, 2015, to regain compliance with the Rule. If at any time before April 21, 2015, the bid price of the Company's common stock closes at or above \$1.00 per share for a minimum of 10 consecutive business days, NASDAQ will provide written notification that the Company has achieved compliance with the Rule.

If compliance with the Rule cannot be demonstrated by April 21, 2015, the Company may be eligible for additional time, provided that the Company can meet all other initial listing requirements for the Nasdaq Capital Market and provides written notice of its intention to cure the deficiency during the second compliance period of an additional 180 days, by various plans, including effecting a reverse stock split, if necessary.

We intend to continue actively monitoring the bid price for our common stock between now and April 21, 2015, and will consider available options to resolve the deficiency and regain compliance with the NASDAQ minimum bid price requirement. There is no assurance, however, that the Company will pursue efforts to continue to be listed, that the Company will be eligible for an additional compliance period or that our common stock will not be delisted from NASDAQ.

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

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

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

our ability to execute on our restructuring;

the potential for disruption and loss of customers and business from the transfer of duties and responsibilities as a result of our restructuring;

our ability to halt the decline of our cash reserves in light of our continued losses;

our ability to raise additional capital to fund our operations and such capital may not be available to us at commercially reasonable terms or at all;

our customer concentration given that the majority of our sales depend on a few large client relationships, including Sprint;

changes in demand for our products from our key customers and their end-users;

our business and stock price may decline further which could cause an additional impairment of long-lived assets or restructuring charges resulting in a material adverse effect on our financial condition and results of operations;

our ability to successfully execute our business and restructuring plan and control costs and expenses;

we risk being delisted from NASDAQ if our stock does not trade over \$1.00 per share for 10 straight business days by April 21, 2015;

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

the pace at which the market for new products develop;

the intensity of the competition and our ability to successfully compete;

our ability to hire and retain key personnel;

the availability of third party intellectual property and licenses which may not be on commercially reasonable terms, or not at all;

our ability to protect our intellectual property and our ability to not infringe on the rights of others;

the ongoing uncertainty and volatility in U.S. and worldwide economic conditions may adversely affect our operating results;

security and privacy breaches in our systems may damage client relations and inhibit our ability to grow;

interruptions or delays in the services we provide from our data center hosting facilities could harm our business; and

those additional factors which are listed under the Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2013 and in this 10-Q on Page 23.

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

Table of Contents**Overview**

Smith Micro Software, Inc. provides software and services that simplify, secure and enhance the mobile experience. The Company's portfolio of wireless solutions includes a wide range of client and server applications that manage devices, communications and network connectivity for end-users as well as Machine-to-Machine (M2M) endpoints. Our primary customers are the world's leading wireless service providers, mobile device and chipset manufacturers, and enterprise businesses. In addition to our wireless and mobility software, Smith Micro offers personal productivity, graphics and animation products distributed through a variety of consumer channels worldwide.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Wireless:				
Sprint (& affiliates)	67.1%	61.5%	67.3%	55.6%
Verizon Wireless (& affiliates)	8.2%	9.8%	7.4%	14.9%
Productivity & Graphics:				
FastSpring	10.0%	13.6%	11.8%	11.9%

These three customers listed above comprised 94% and 88% of our accounts receivable at September 30, 2014 and 2013, respectively.

Results of Operations

The table below sets forth certain statements of comprehensive loss data expressed as a percentage of revenues for the three and nine months ended September 30, 2014 and 2013. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	23.3	28.5	26.8	23.8
Gross profit	76.7	71.5	73.2	76.2
Operating expenses:				
Selling and marketing	22.7	42.4	28.3	41.0
Research and development	33.7	61.2	41.8	55.8
General and administrative	32.4	52.3	39.2	46.6
Restructuring expense		64.0	9.2	18.2
Total operating expenses	88.8	219.9	118.5	161.6
Operating loss	(12.1)	(148.4)	(45.3)	(85.4)

Interest and other income (expense), net		0.1		0.1
Loss before provision for income taxes	(12.1)	(148.3)	(45.3)	(85.3)
Provision for income tax expense (benefit)		0.9	0.1	0.5
Net loss	(12.1)%	(149.2)%	(45.4)%	(85.8)%

Revenues and Expense Components

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

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

Wireless, which includes our QuickLink®, NetWise® and CommSuite® family of products; and

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

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

	Three Months Ended September 30,		One Months Ended September 30,	
	2014	2013	2014	2013
Wireless	\$ 8,355	\$ 7,243	\$ 22,205	\$ 25,989
Productivity & Graphics	1,093	1,503	4,220	4,843
Total revenues	9,448	8,746	26,425	30,832
Cost of revenues	2,201	2,492	7,072	7,337
Gross profit	\$ 7,247	\$ 6,254	\$ 19,353	\$ 23,495

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

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

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

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

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

Interest and other income (expense), net. Interest and other income are primarily related to our average cash and short term investment balances during the period. Interest and other expense are primarily related to the credit-adjusted risk-free interest rate used to measure our operating lease termination liabilities in restructuring.

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

Three Months Ended September 30, 2014 Compared to the Three Months Ended September 30, 2013

Revenues. Revenues were \$9.4 million and \$8.7 million for the three months ended September 30, 2014 and 2013, respectively, representing a decrease of \$0.7 million, or 8.0%. Wireless revenues increased \$1.1 million, or 15.4%, primarily due to increases from CommSuite of \$0.6 million, NetWise of \$0.4 million, and QuickLink of \$0.1 million. Productivity & Graphics revenues decreased \$0.4 million, or 27.3%, primarily due to new releases of Poser and Manga Studio last year not repeating this year as we shift our future focus from consumers to new professional markets such as gaming and industrial design. While we have launched new wireless products, they are new to the market and their rate of adoption and deployment is unknown at this time causing material uncertainty regarding the timing of our future wireless revenues.

Cost of revenues. Cost of revenues was \$2.2 million and \$2.4 million for the three months ended September 30, 2014 and 2013, respectively, representing a decrease of \$0.2 million, or 11.7%. This decrease was primarily due to cost savings realized from our restructurings.

Gross profit. Gross profit was \$7.2 million, or 76.7% of revenues for the three months ended September 30, 2014, an increase of \$0.9 million, or 15.9%, from \$6.3 million, or 71.5% of revenues for the three months ended September 30, 2013. The 5.2 percentage point increase was primarily due to increased revenues, a more profitable product mix, and cost savings as a result of our restructurings.

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Selling and marketing. Selling and marketing expenses were \$2.1 million and \$3.7 million for the three months ended September 30, 2014 and 2013, respectively, representing a decrease of \$1.6 million, or 42.3%. This decrease was primarily due to headcount reductions resulting from our restructurings of \$1.2 million and other cost reductions of \$0.3 million. Stock-based compensation decreased from \$0.2 million to \$0.1 million, or \$0.1 million primarily due to the reduced headcount and lower stock price.

Research and development. Research and development expenses were \$3.2 million and \$5.3 million for the three months ended September 30, 2014 and 2013, respectively, representing a decrease of \$2.1 million, or 40.5%. This decrease was primarily due to headcount reductions resulting from our restructurings of \$2.0 million and other cost reductions of \$0.1 million. Stock-based compensation was essentially flat at \$0.2 million for both of the three months ended September 30, 2014 and 2013.

General and administrative. General and administrative expenses were \$3.1 million and \$4.6 million for the three months ended September 30, 2014 and 2013, respectively, representing a decrease of \$1.5 million, or 33.0%. This decrease was primarily due to lower space and occupancy costs of \$0.6 million, headcount reductions of \$0.3 million resulting from our restructurings, lower depreciation of \$0.3 million, and other cost reductions of \$0.1 million. Stock-based compensation decreased from \$0.5 million to \$0.3 million, or \$0.2 million primarily due to the reduced headcount and lower stock price.

Restructuring expense. There was no restructuring expense for the three months ended September 30, 2014. Restructuring expenses were \$5.6 million for the three months ended September 30, 2013. These charges were for lease/rental terminations of \$3.2 million, severance costs for affected employees of \$1.2 million, fixed asset write-offs as a result of our lease/rental terminations of \$1.0 million and other related costs of \$0.2 million.

Interest and other income (expense), net. Interest and other income, net, was \$3,000 of expense and \$7,000 of income for the three months ended September 30, 2014 and 2013, respectively.

Provision for income tax expense. We recorded an income tax benefit of \$5,000 for the three months ended September 30, 2014. We recorded income tax expense of \$76,000 for the three months ended September 30, 2013. The income tax expenses for both periods only reflect state income tax minimums and foreign income taxes.

Nine Months Ended September 30, 2014 Compared to the Nine Months Ended September 30, 2013

Revenues. Revenues were \$26.4 million and \$30.8 million for the nine months ended September 30, 2014 and 2013, respectively, representing a decrease of \$4.4 million, or 14.3%. Wireless revenues decreased \$3.8 million, or 14.6%, primarily due to decreases in our legacy connection manager products of \$5.0 million and \$0.8 million of NetWise. These decreases were partially offset by increases in our CommSuite product lines of \$2.0 million. Productivity & Graphics revenues decreased \$0.6 million, or 12.9% primarily due to lower customer demand and fewer new releases this year as we shift our future focus from consumers to new professional markets such as gaming and industrial design. While we have launched new wireless products, they are new to the market and their rate of adoption and deployment is unknown at this time causing material uncertainty regarding the timing of our future wireless revenues.

Cost of revenues. Cost of revenues was \$7.1 million and \$7.3 million for the nine months ended September 30, 2014 and 2013, respectively, representing a decrease of \$0.2 million, or 3.6%. This decrease was primarily due to cost savings realized from our restructurings which more than offset increased royalties resulting from our product mix.

Gross profit. Gross profit was \$19.3 million, or 73.2% of revenues for the nine months ended September 30, 2014, a decrease of \$4.2 million, or 17.6%, from \$23.5 million, or 76.2% of revenues for the nine months ended

September 30, 2013. The 3.0 percentage point decrease was primarily due to lower revenues and a less profitable product mix.

Selling and marketing. Selling and marketing expenses were \$7.5 million and \$12.7 million for the nine months ended September 30, 2014 and 2013, respectively, representing a decrease of \$5.2 million, or 41.0%. This decrease was primarily due to headcount reductions resulting from our restructurings of \$3.6 million and other cost reductions of \$1.0 million. Stock-based compensation decreased from \$0.8 million to \$0.2 million, or \$0.6 million primarily due to the reduced headcount and lower stock price.

Research and development. Research and development expenses were \$11.0 million and \$17.2 million for the nine months ended September 30, 2014 and 2013, respectively, representing a decrease of \$6.2 million, or 35.7%. This decrease was primarily due to headcount reductions resulting from our restructurings of \$5.6 million and other cost reductions of \$0.4 million. Stock-based compensation decreased from \$0.7 million to \$0.5 million, or \$0.2 million primarily due to the reduced headcount and lower stock price.

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General and administrative. General and administrative expenses were \$10.4 million and \$14.4 million for the nine months ended September 30, 2014 and 2013, respectively, representing a decrease of \$4.0 million, or 27.9%. This decrease was primarily due to lower space & occupancy costs of \$1.5 million, headcount reductions resulting from our restructurings of \$0.7 million, lower depreciation of \$0.7 million, lower legal fees of \$0.5 million, and other cost reductions of \$0.3 million. Stock-based compensation decreased from \$1.5 million to \$1.2 million, or \$0.3 million primarily due to the reduced headcount and lower stock price.

Restructuring expense. Restructuring expense was \$2.4 million for the nine months ended September 30, 2014 due to one-time employee terminations of \$1.3 million of non-cash stock-based compensation and \$0.4 million of severance costs, \$0.6 million for lease terminations, and \$0.1 million of other related expenses. Restructuring expenses were \$5.6 million for the nine months ended September 30, 2013. These charges were for lease/rental terminations of \$3.2 million, severance costs for affected employees of \$1.2 million, fixed asset write-offs as a result of our lease/rental terminations of \$1.0 million and other related costs of \$0.2 million.

Interest and other income (expense), net. Interest and other income, net, was \$5,000 of expense and \$27,000 of income for the nine months ended September 30, 2014 and 2013, respectively.

Provision for income tax expense. We recorded income tax expense of \$40,000 and \$149,000 for the nine months ended September 30, 2014 and 2013. These amounts only reflect state income tax minimums and foreign income taxes.

Liquidity and Capital Resources

At September 30, 2014, we had \$12.7 million in cash and cash equivalents and short-term investments and \$13.2 million of working capital.

In August 2014, the Company entered into a common stock purchase agreement (see Note 14) with a number of accredited Investors in a private placement pursuant to which the Company agreed to issue and sell to the investors an aggregate of 6,845,830 shares of its common stock at a price per share of \$0.816. The transaction closed on August 20, 2014 and the Company realized gross proceeds of \$5.6 million before deducting commissions and other expenses of \$0.3 million.

In May 2014, the Board approved a restructuring plan (see Note 16) that was implemented during the fiscal quarter ending June 30, 2014 which lowered our overall cost structure by approximately \$2.0 million per quarter.

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

Operating activities

Net cash used in operating activities was \$7.4 million for the nine months ended September 30, 2014. The primary uses of operating cash were to fund our net loss of \$12.0 million, decreases in accounts payables and accrued liabilities of \$1.1 million, increases in prepaid expenses of \$0.3 million, and increases of accounts receivable of \$0.1 million. These decreases were partially offset by non-cash expenses including stock-based compensation of \$3.1 million, depreciation and amortization of \$2.4 million, and accounts receivable and inventory reserves of \$0.4 million, and increases in deferred revenue of \$0.2 million.

Net cash used in operating activities was \$13.4 million for the nine months ended September 30, 2013. The primary uses of operating cash were to fund our net loss of \$26.5 million and decreases in our prepaid expenses of \$0.3 million. These were partially offset by non-cash expenses including depreciation and amortization of \$3.1 million, stock-based compensation of \$2.7 million, the write-off of fixed assets due to our restructuring of \$1.0 million, and accounts receivable and inventory reserves of \$0.5 million. Other cash increases were due to increases in accounts payable and accrued expenses of \$4.6 million, and decreases in accounts receivable of \$1.5 million.

Investing activities

Net cash provided by investing activities was \$0.8 million for the nine months ended September 30, 2014 due to the sale of short-term investments of \$0.9 million, less capital expenditures of \$0.1 million.

Net cash provided by investing activities was \$5.3 million for the nine months ended September 30, 2013 due to the sale of short-term investments of \$6.1 million, partially offset by capital expenditures of \$0.8 million.

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During the nine months ended September 30, 2014, we received \$5.3 million from the sale of our common stock in a private placement. We also received \$21,000 from the stock sale for the employee stock purchase plan and \$6,000 from the exercise of stock options.

During the nine months ended September 30, 2013, we received \$36,000 from the stock sale for the employee stock purchase plan.

Contractual obligations and commercial commitments

As of September 30, 2014 we had no debt. The following table summarizes our contractual obligations as of September 30, 2014 (in thousands):

Contractual obligations:	Total	Payments due by period			
		1 year or less	1-3 years	3-5 years	More than 5 years
Operating Lease Obligations	\$ 12,327	\$ 2,242	\$ 3,578	\$ 2,926	\$ 3,581
Purchase Obligations	912	912			
Total	\$ 13,239	\$ 3,154	\$ 3,578	\$ 2,926	\$ 3,581

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

Real Property Leases

Our corporate headquarters, including our principal administrative, sales and marketing, customer support and research and development facility, is located in Aliso Viejo, California, where we currently lease and occupy approximately 33,600 square feet of space pursuant to lease that expires on May 31, 2016. We lease approximately 55,600 square feet in Pittsburgh, Pennsylvania under a lease that expires December 31, 2021. We lease approximately 16,000 square feet in Sunnyvale, California under a lease that expires February 28, 2015. Internationally, we lease space in Belgrade, Serbia that expires December 30, 2016.

We lease an additional 19,100 square feet in Aliso Viejo, California under a lease that expires January 31, 2022. In August 2014, we signed an addendum to sublease all of the space commencing on September 15, 2014 for a three year

period, with two, two-year renewal options. The remaining lease expense, net of sublease income, has already been accrued for in our 2013 restructuring liability account.

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

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

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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 collectability is probable as required by FASB ASC Topic No. 985-605, Software-Revenue Recognition. We recognize revenues from sales of our software to our customers or end users as completed products are shipped and title passes; or from royalties generated as authorized customers duplicate our software, if the other requirements are met. If the requirements are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. For Wireless sales, returns from customers are limited to defective goods or goods shipped in error. Historically, customer returns have not exceeded the very nominal estimates and reserves. We also provide some technical support to our customers. Such costs have historically been insignificant.

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

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

Accounts Receivable and Allowance for Doubtful Accounts

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

Impairment or Disposal of Long Lived Assets

Long-lived assets to be held are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. They are tested for recoverability using undiscounted cash flows to determine whether or not impairment to such value has occurred as required by FASB ASC Topic No. 360, Property, Plant, and Equipment. The Company determined there was no impairment as of September 30, 2014.

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Income Taxes

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

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, 2014, the carrying values of our financial instruments approximated fair values based on current market prices and rates.

Foreign Currency Risk

While a majority of our business is denominated in U.S. dollars, we do invoice in foreign currencies. For the three months ended September 30, 2014 and 2013, our revenues denominated in foreign currencies were de minimis. For the nine months ended September 30, 2014 and 2013, our revenues denominated in foreign currencies were \$35,000 and \$0.1 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, 2014. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have determined that as of September 30, 2014, our disclosure controls and procedures were effective to ensure that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how

well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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.

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

Changes in internal control over financial reporting

There have been no changes in our internal controls over financial reporting during the quarter ended September 30, 2014 that have materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

You should carefully consider and evaluate all of the information in this Quarterly Report and the risk factors set forth below and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013, which was filed with the SEC on March 7, 2014 (the Form 10-K). The risks set forth below and in our Form 10-K are not the only ones that we face. Additional risks that are not known to us or that we currently deem immaterial may also impair our business operations. If any of these risks actually occur, our business could be materially harmed and the trading price of our common stock could decline. Please also refer to Management's Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report for a discussion of certain factors that may affect our future performance.

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

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

On May 6, 2014, the Board of Directors approved a plan of restructuring intended to streamline and flatten the Company's organization, reduce overall headcount by approximately 20% and reduce its overall cost structure by approximately \$2.0 million per quarter. This resulted in a special one-time restructuring charge of \$1.8 million that was recorded in the fiscal quarter ending June 30, 2014. If the demand for our legacy and new products does not increase, we may need to take additional restructuring actions in future quarters, although we currently do not have any intention to do so. If future restructuring actions are taken, this could have a material adverse effect on our financial condition and results of operations in the period that the action is taken.

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

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

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

We believe that the cash and cash equivalents and short-term investments on hand and the cash we expect to generate from operations will be sufficient to meet our capital needs for at least the next twelve months. However, it is possible that we may need or choose to obtain additional financing to fund our activities in the future. We could raise these funds by selling more stock to the public or to selected investors, borrowing money, or by pursuing strategic alternatives for one or more of our product lines. We may not be able to obtain additional funds on favorable terms, or at all. If adequate funds are not available, we may be required to curtail our operations or other business activities significantly or to obtain funds through arrangements with strategic partners or others that may require us to relinquish rights to certain technologies or potential markets.

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

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

On August 7, 2014, we received a letter from the NASDAQ Stock Market LLC stating that, based on our June 30, 2014 reported stockholders' equity of \$9.6 million, the Company no longer met the requirement of NASDAQ Rule 5450(b)(1)(A), which requires companies listed on the NASDAQ Global Select Market to maintain a minimum of \$10,000,000 in stockholders' equity for continued listing (the Minimum Stockholders' Equity Rule). However, as a result of the proceeds from the Company's recent private placement stock offering, the Company has regained compliance with the Minimum Stockholders' Equity Rule. Nevertheless, there can be no assurance that the Company will in the future maintain compliance with the Minimum Stockholders' Equity Rule or other requirements for continued listing on NASDAQ.

On October 23, 2014, we received a written notification from the NASDAQ Stock Market LLC notifying the Company that it fails to comply with Nasdaq's Marketplace Rule 5450(a)(1) (the Rule) because the bid price for the Company's common stock over the last 30 consecutive business days has closed below the minimum \$1.00 per share requirement for continued listing. The notification has no immediate effect on the listing of the Company's common stock. In accordance with NASDAQ's Marketplace Rule 5810(c)(3)(A), the Company has a period of 180 calendar days, or until April 21, 2015, to regain compliance with the Rule. If at any time before April 21, 2015, the bid price of the Company's common stock closes at or above \$1.00 per share for a minimum of 10 consecutive business days, NASDAQ will provide written notification that the Company has achieved compliance with the Rule. If compliance with the Rule cannot be demonstrated by April 21, 2015, the Company may be eligible for additional time, provided that the Company can meet all other initial listing requirements for the Nasdaq Capital Market and provides written notice of its intention to cure the deficiency during the second compliance period of an additional 180 days, by various plans, including effecting a reverse stock split, if necessary. We intend to continue actively monitoring the bid price for our common stock between now and April 21, 2015, and will consider available options to resolve the deficiency and regain compliance with the NASDAQ minimum bid price requirement. There is no assurance, however, that the Company will pursue efforts to continue to be listed, that the Company will be eligible for an additional compliance period or that our common stock will not be delisted from NASDAQ.

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

On August 15, 2014, the Company entered into a common stock purchase agreement with a number of accredited investors pursuant to which the Company issued and sold 6,845,830 shares of its common stock at a price per share of \$0.816 in a private placement. The transaction closed on August 20, 2014 and the Company realized gross proceeds of \$5.6 million before deducting commissions and other expenses. Offering costs related to the transaction totaled \$0.3 million, comprised of \$0.2 million of commissions and \$0.1 million of legal and other expenses, resulting in net proceeds of \$5.3 million. The offer and sale of the shares of Common Stock in the private placement was exempt from registration pursuant to Section 4(2) of and Rule 506 of Regulation D promulgated under the Securities Act of 1933, as amended.

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The table set forth below shows all repurchases of securities by us during the three months ended September 30, 2014:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares (or Units) Purchased	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Jul. 1-31, 2014				
Aug. 1-31, 2014				
Sep. 1-30, 2014	50,698(a)	\$ 0.97		
Total	50,698	\$ 0.97		

The above table includes:

(a) Acquisition of stock by the Company as payment of withholding taxes in connection with the vesting of restricted stock awards, in an aggregate amount of 50,698 shares during the periods set forth in the table.

Item 6. Exhibits

10.12	Form of Common Stock Purchase Agreement, dated August 15, 2014, incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 20, 2014.
10.13	Form of Registration Rights Agreement, dated August 15, 2014, incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on August 20, 2014.
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

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

SMITH MICRO SOFTWARE, INC.

October 31, 2014

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

October 31, 2014

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