

SMITH MICRO SOFTWARE INC

Form 10-Q

November 04, 2010

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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, 2010
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 <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>
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Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes No

As of October 29, 2010 there were 34,279,087 shares of common stock outstanding.

SMITH MICRO SOFTWARE, INC.
QUARTERLY REPORT ON FORM 10-Q
September 30, 2010
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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, 2010 (unaudited)	December 31, 2009 (audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 12,302	\$ 14,577
Short-term investments	45,222	31,284
Accounts receivable, net of allowances for doubtful accounts and other adjustments of \$915 (2010) and \$1,045 (2009)	32,277	24,147
Income tax receivable	980	980
Inventories, net of reserves for excess and obsolete inventory of \$1,341 (2010) and \$1,221 (2009)	382	406
Prepaid expenses and other current assets	1,106	1,506
Deferred tax asset	2,693	2,696
 Total current assets	 94,962	 75,596
Equipment and improvements, net	10,339	8,193
Goodwill	94,231	94,320
Intangible assets, net	21,537	27,662
Other assets	190	163
 Total assets	 \$ 221,259	 \$ 205,934
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 4,140	\$ 4,215
Accrued liabilities	11,519	11,359
Deferred revenue	2,098	1,317
 Total current liabilities	 17,757	 16,891
Non-current liabilities:		
Deferred rent and other long-term liabilities	170	70
Deferred tax liability	997	994
 Total non-current liabilities	 1,167	 1,064
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; 34,279,087 and 33,380,496 shares issued and outstanding at September 30,	34	33

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2010 and December 31, 2009, respectively

Additional paid-in capital	191,550	183,756
Accumulated other comprehensive loss	(12)	(2)
Accumulated earnings	10,763	4,192
Total stockholders' equity	202,335	187,979
Total liabilities and stockholders' equity	\$ 221,259	\$ 205,934

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,	
	2010	2009	2010	2009
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Revenues	\$ 34,008	\$ 27,820	\$ 95,227	\$ 77,594
Cost of revenues	3,771	3,540	11,468	11,985
Gross profit	30,237	24,280	83,759	65,609
Operating expenses:				
Selling and marketing	7,344	5,946	22,032	18,371
Research and development	10,972	9,229	31,195	26,066
General and administrative	6,059	4,967	18,082	13,962
Total operating expenses	24,375	20,142	71,309	58,399
Operating income	5,862	4,138	12,450	7,210
Interest and other income	82	121	115	495
Income before taxes	5,944	4,259	12,565	7,705
Income tax expense	2,850	2,278	5,994	4,169
Net income	\$ 3,094	\$ 1,981	\$ 6,571	\$ 3,536
Net income per share:				
Basic	\$ 0.09	\$ 0.06	\$ 0.19	\$ 0.11
Diluted	\$ 0.09	\$ 0.06	\$ 0.19	\$ 0.11
Weighted average shares outstanding:				
Basic	34,274	32,523	34,091	32,182
Diluted	34,736	33,145	34,560	32,641

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 Shares	Common stock Amount	Additional paid-in capital	Accumulated other comprehensive loss	Accumulated earnings	Total
BALANCE, December 31, 2009	33,380	\$ 33	\$ 183,756	\$ (2)	\$ 4,192	\$ 187,979
Exercise of common stock options	69		349			349
Non cash compensation recognized on stock options			3,387			3,387
Restricted stock grants	854	1	3,624			3,625
Cancellation of shares for payment of withholding tax	(24)		(212)			(212)
Excess tax benefit related to stock compensation			648			648
Tax deficiencies related to stock compensation			(2)			(2)
Other comprehensive income:						
Unrealized loss on short-term investments				(10)		(10)
Net income					6,571	6,571
Total comprehensive income						6,561
BALANCE, September 30, 2010 (unaudited)	34,279	\$ 34	\$ 191,550	\$ (12)	\$ 10,763	\$ 202,335

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	
	2010	2009
	(unaudited)	(unaudited)
Operating activities:		
Net income	\$ 6,571	\$ 3,536
Adjustments to reconcile net income to net cash provided by operating activities, net of the effect of acquisitions:		
Depreciation and amortization	8,911	7,645
Loss on disposal of assets		20
Provision for doubtful accounts and other adjustments to accounts receivable	908	1,190
Provision for excess and obsolete inventory	167	896
Tax benefits from stock-based compensation	(648)	(779)
Non cash compensation related to stock options & restricted stock	7,012	6,660
Change in operating accounts, net of effect from acquisitions:		
Accounts receivable	(9,038)	(6,059)
Deferred income taxes	4	
Inventories	(143)	(305)
Prepaid expenses and other assets	373	68
Accounts payable and accrued liabilities	1,301	709
Net cash provided by operating activities	15,418	13,581
Investing activities:		
Adjustments made to the acquisition of Core Mobility	143	
Acquisition of Avot Media, net of cash received	(675)	
Capital expenditures	(4,210)	(4,006)
Purchase of short-term investments	(13,948)	(9,762)
Net cash used in investing activities	(18,690)	(13,768)
Financing activities:		
Tax benefits from stock-based compensation	648	779
Cash received from exercise of stock options	349	1,617
Net cash provided by financing activities	997	2,396
Net increase (decrease) in cash and cash equivalents	(2,275)	2,209
Cash and cash equivalents, beginning of period	14,577	13,966
Cash and cash equivalents, end of period	\$ 12,302	\$ 16,175

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Supplemental disclosures of cash flow information:

Cash paid for income taxes	\$	3,389	\$	5,189
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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) designs, develops and markets software products and services primarily for the mobile computing and communications industries. The Company is focused on developing connectivity, communications and content management solutions for a converging world of wireless and wired networks. The Company's portfolio of wireless software products and services includes a wide range of software solutions including our QuickLink® family of products. We provide mobile voice and data connectivity across 3G, 4G, Wi-Fi, and LTE networks. Our mobile communications portfolio includes solutions for Push-To-Talk, Visual Voicemail and mobile device management. We also offer user-friendly solutions for the management of mobile content, contacts and calendar data. We sell our products and services to many of the world's leading mobile network operators, original equipment manufacturers (OEM), device manufacturers and enterprise businesses, as well as directly to consumers.

2. Basis of Presentation

The accompanying interim consolidated balance sheet and statement of stockholders' equity as of September 30, 2010, the related statements of operations for the three and nine months ended September 30, 2010 and 2009 and the related statements of cash flows for the nine months ended September 30, 2010 and 2009 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, 2009 filed with the SEC on March 2, 2010.

Intercompany balances and transactions have been eliminated in consolidation.

Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2010.

3. Net Income Per Share

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

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(unaudited, in thousands, except per share amounts)			
Numerator:				
Net income available to common stockholders	\$ 3,094	\$ 1,981	\$ 6,571	\$ 3,536
Denominator:				
Weighted average shares outstanding basic	34,274	32,523	34,091	32,182
Potential common shares options (treasury stock method)	462	622	469	459
Weighted average shares outstanding diluted	34,736	33,145	34,560	32,641
Shares excluded due to an exercise price greater than weighted average stock price for the period	2,410	2,462	2,410	2,501
Net income per common share:				
Basic	\$ 0.09	\$ 0.06	\$ 0.19	\$ 0.11
Diluted	\$ 0.09	\$ 0.06	\$ 0.19	\$ 0.11

4. Acquisitions***Core Mobility, Inc.***

On October 26, 2009, the Company acquired Core Mobility, Inc. (*Core Mobility*), a developer of mobility software and solutions, for \$10.0 million in cash and 700,000 shares of Smith Micro common stock. Core Mobility became a wholly-owned subsidiary of Smith Micro. In addition, the former shareholders of Core Mobility had the ability to earn additional cash consideration of up to \$1.8 million contingent on Core Mobility achieving certain milestone deliverables for product development and deployment. In March 2010, a milestone payment of \$0.6 million was made. Of the \$10.0 million of cash consideration, \$3.0 million was held back (*Holdback*) as security against possible indemnification obligations. In June 2010, \$1.5 million of the Holdback was paid. Assuming there are no claims, the remaining 50% of the Holdback will be paid on the one year anniversary. Acquisition-related costs of \$0.2 million were recorded as expense in the fiscal year ended December 31, 2009 in the general and administrative section of the consolidated statement of operations.

The total purchase price is summarized as follows (in thousands):

Cash paid at closing	\$ 6,970
Holdback (including interest)	3,041
Common stock issued	6,881
Milestone payments	1,839
Total purchase price	\$ 18,731

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The Company's allocation of the purchase price is summarized as follows (in thousands):

Assets:	
Cash	\$ 63
Accounts receivable	997
Unbilled receivable	324
Prepaid and other assets	279
Fixed assets	856
Deferred tax assets	1,735
Intangible assets	8,858
Goodwill	10,694
 Total assets	 23,806
 Liabilities:	
Accounts payable	26
Accrued expenses	258
Deferred revenue	1,280
Deferred tax liability	3,511
 Total liabilities	 5,075
 Total purchase price	 \$ 18,731

The results of operations of Core Mobility have been included in the Company's consolidated financial statements from the date of acquisition. The pro-forma effect of the acquisition on historical periods is not material and therefore not included.

5. 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 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 could not exceed 5,000,000 shares, plus that number of 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 Expense

The Company accounts for all stock-based payment awards made to employees and directors based on their fair values and recognized as compensation expense over the vesting period using the straight-line method over the requisite service period for each award as required by FASB ASC Topic No. 718, Compensation-Stock Compensation.

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

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2010	2009	2010	2009
Cost of revenues	\$ 23	\$ 28	\$ 76	\$ 157
Selling and marketing	627	592	1,890	1,898
Research and development	615	643	1,817	1,899
General and administrative	1,079	782	3,229	2,706
Total non-cash stock compensation expense	\$ 2,344	\$ 2,045	\$ 7,012	\$ 6,660

Total share-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 of the three months ended September 30, 2010 and 2009. The cash payment of income taxes related to grants of restricted stock totaled \$1.5 million and \$0.8 million for the nine months ended September 30, 2010 and 2009, respectively.

Stock Options

There were no stock options granted during the three months ended September 30, 2010. There were 20,000 stock options granted during the nine months ended September 30, 2010. There were 25,000 stock options granted during the three and nine months ended September 30, 2009. The weighted average grant-date fair value of stock options granted during the nine months ended September 30, 2010 was \$2.97. 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 assumptions used to compute the stock-based compensation costs for the stock options granted during the three and nine months ended September 30, 2010 and 2009, using the Black-Scholes option pricing model, were as follows:

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2010	2009	2010	2009
Employee Stock Options				
Risk-free interest rate		0.5%	0.32%	0.5%
Expected dividend yield				
Weighted average expected life (years)		1	1	1
Volatility		71.0%	72.0%	71.0%
Forfeiture rate				

The risk-free interest rate assumption was based on the United States Treasury's rates for