SMITH MICRO SOFTWARE INC
Form 10-Q
May 07, 2009

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

(Mark One)

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

For the quarterly period ended March 31, 2009

OR

o **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	**33-0029027**
(State or other jurisdiction of incorporation or organization)	(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 þ No o

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 o No o

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

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

As of April 30, 2009 there were 32,261,000 shares of common stock outstanding.

SMITH MICRO SOFTWARE, INC.
QUARTERLY REPORT ON FORM 10-Q
March 31, 2009
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31 2009 (unaudited)	December 31, 2008 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 10,772	$ 13,966
Short-term investments	30,188	$ 22,649
Accounts receivable, net of allowances for doubtful accounts and other adjustments of $1,128 (2009) and $1,204 (2008)	19,387	18,424
Deferred tax asset	1,587	1,698
Inventories, net of reserves for obsolete inventory of $756 (2009) and $404 (2008)	723	1,097
Prepaid expenses and other current assets	1,266	1,026
Total current assets	63,923	58,860
Equipment and improvements, net	4,775	4,289
Goodwill	83,483	83,483
Intangible assets, net	25,453	27,603
Deferred tax asset	2,760	2,760
Total assets	$ 180,394	$ 176,995
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 3,071	$ 3,492
Accrued liabilities	6,352	6,710
Deferred revenue	2,647	923
Total current liabilities	12,070	11,125
Long-term liabilities	386	466
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value $0.001 per share; 5,000,000 shares authorized; none issued or outstanding		
Common stock, par value $0.001 per share; 50,000,000 shares authorized; 32,261,000 and 31,400,000 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	32	31
Additional paid-in capital	168,164	165,864
Accumulated other comprehensive income	24	69

Accumulated deficit	(282)	(560)
Total stockholders equity	167,938	165,404
Total liabilities and stockholders equity	$ 180,394	$ 176,995

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended March 31,	
	2009	2008
	(unaudited)	(unaudited)
Revenues	$ 23,788	$ 21,880
Cost of revenues	4,523	5,116
Gross profit	19,265	16,764
Operating expenses:		
Selling and marketing	6,277	6,735
Research and development	8,112	7,069
General and administrative	4,487	4,848
Total operating expenses	18,876	18,652
Operating income (loss)	389	(1,888)
Interest and other income	255	275
Profit (loss) before taxes	644	(1,613)
Income tax expense (benefit)	366	(1,296)
Net income (loss)	$ 278	$ (317)
Net income (loss) per share:		
Basic	$ 0.01	$ (0.01)
Diluted	$ 0.01	$ (0.01)
Weighted average shares outstanding:		
Basic	31,675	30,406
Diluted	31,904	30,406

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 paid-in	Accumulated other comprehensive	Accumulated income	
	Shares	**Amount**	**capital**	**income**	**(deficit)**	**Total**
BALANCE, December 31, 2008	**31,400**	**$ 31**	**$ 165,864**	**$ 69**	**$ (560)**	**$ 165,404**
Exercise of common stock options	17		33			33
Non cash compensation recognized on stock options			1,441			1,441
Restricted stock grants	845	1	932			933
Cancellation of shares for payment of withholding tax	(1)		(5)			(5)
Excess tax benefit related to stock compensation			10			10
Tax deficiencies related to stock compensation			(111)			(111)
Other comprehensive income:						
Change in unrealized gain on short-term investments				(45)		(45)
Net income					278	278
Total comprehensive income						233
BALANCE, March 31, 2009	**32,261**	**$ 32**	**$ 168,164**	**$ 24**	**$ (282)**	**$ 167,938**

See accompanying notes to the unaudited consolidated financial statements.

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

	Three Months Ended March 31,	
	2009 (unaudited)	2008 (unaudited)
Operating activities:		
Net income (loss)	$ 278	$ (317)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities, net of the effect of acquisitions:		
Depreciation and amortization	2,510	2,116
Provision for doubtful accounts and other adjustments to accounts receivable	269	382
Provision for excess and obsolete inventory	385	3
Tax benefits from stock-based compensation	(10)	207
Non cash compensation related to stock options & restricted stock	2,374	3,339
Change in operating accounts, net of effect from acquisitions:		
Accounts receivable	(1,232)	(4,191)
Deferred income taxes		(1,298)
Inventories	(11)	217
Prepaid expenses and other assets	(240)	(580)
Accounts payable and accrued liabilities	870	(411)
Net cash provided by (used in) operating activities	5,193	(533)
Investing activities:		
Acquisition of eFrontier America, net of cash received		(16)
Acquisition of Insignia Solutions, net of cash received		(69)
Acquisition of PCTel s Mobile Solutions Group, net of cash received		(60,327)
Capital expenditures	(846)	(198)
Purchase of short-term investments	(7,584)	
Net cash used in investing activities	(8,430)	(60,610)
Financing activities:		
Tax benefits from stock-based compensation	10	(207)
Cash received from exercise of stock options	33	10
Net cash provided by (used in) financing activities	43	(197)
Net decrease in cash and cash equivalents	(3,194)	(61,340)
Cash and cash equivalents, beginning of period	13,966	87,549
Cash and cash equivalents, end of period	$ 10,772	$ 26,209

Supplemental disclosures of cash flow information:				
Cash paid for income taxes	$	661	$	9

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 softw products and services for the mobile industry. The Company is focused on developing connectivity, multimedia, and device management solutions for a converging world of wireless and wired networks. The Company s portfolio of wireless software products and services include the QuickLink family of desktop and mobile products to manage wireless data communications; including software applications for 3G and 4G broadband mobile networks, Wi-Fi, personal information management, mobile content management, device management, and data compression solutions. We sell our products and services to many of the world s leading wireless service providers (carriers), original equipment manufacturers (OEM), PC and device manufacturers, enterprise businesses, as well as direct to consumers. The proliferation of broadband mobile wireless technologies is providing new opportunities for our products and services on a global basis. When these broadband wireless technologies EVDO, UMTS/HSPA, Wi-Fi, and WiMAX are combined with new devices such as mobile phones, Personal Computers (PCs), Netbooks, Smartphones, and Ultra-Mobile PCs (UMPCs), opportunities emerge for new communications software products. Our core technologies are designed to address these emerging mobile convergence opportunities.

In addition, the Company distributes its consumer product lines and a variety of third party Mac and Windows PC products worldwide through our online stores and third-party wholesalers, retailers and value-added resellers.

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

On December 10, 2007, Smith Micro entered into an Asset Purchase Agreement with PCTEL, Inc. pursuant to which Smith Micro agreed to acquire substantially all of the assets of PCTEL s Mobility Solutions Group (MSG). The acquisition was completed on January 4, 2008. Pursuant to the terms of the Asset Purchase Agreement, Smith Micro paid $59.7 million in cash to PCTEL at the closing on January 4, 2008.

2. Basis of Presentation

The accompanying interim consolidated balance sheet and statement of equity as of March 31, 2009, and the related statements of operations and cash flows for the three months ended March 31, 2009 and 2008 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, 2008 filed with the SEC on March 10, 2009.

Intercompany balances and transactions have been eliminated in consolidation.

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

3. Net Income (Loss) Per Share

The Company calculates earnings per share in accordance with the Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings per Share*. Basic earnings per share (EPS) is calculated by dividing the net income/loss available to common stockholders by the weighted average number of common shares outstanding for the period, excluding common stock equivalents. Diluted EPS is computed by dividing the net income/loss 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 March 31,			
	2009		2008	
	(unaudited, in thousands, except per share amounts)			
Numerator:				
Net income (loss) available to common stockholders	$	278	$	(317)
Denominator:				
Weighted average shares outstanding basic		31,675		30,406
Potential common shares options (treasury stock method)		229		
Weighted average shares outstanding diluted		31,904		30,406
Shares excluded (anti-dilutive)				4,610
Shares excluded due to an exercise price greater than weighted average stock price for the period		2,783		
Net income (loss) per common share:				
Basic	$	0.01	$	(0.01)
Diluted	$	0.01	$	(0.01)

4. Acquisitions

PCTEL S Mobility Solutions Group

On January 4, 2008, the Company acquired substantially all of the assets of PCTEL S Mobility Solutions Group in exchange for $59.7 million in cash. The direct acquisition costs incurred to date include $1.2 million of legal and professional services.

The results of operations of the business acquired have been included in the Company s consolidated financial statements from the date of acquisition. Depreciation and amortization related to the acquisition were calculated based on the estimated fair market values and estimated lives for property and equipment and certain identifiable intangible assets acquired.

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

Cash consideration	$ 59,700
Acquisition related costs	1,231
Total purchase price	$ 60,931

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

Assets:	
Property & Equipment	$ 718
Intangible Assets	13,050
Goodwill	50,319
Total Assets	64,087
Liabilities:	
Deferred Revenue	3,156
Total Liabilities	3,156
Total purchase price	$ 60,931

e Frontier, Inc.

In November 2007, the Company acquired certain assets of e frontier America, Inc., a wholly-owned subsidiary of e Frontier, Inc., including e Frontier s Aquazone, Poser and Shade® product suites. The Company paid a total of $5.6 million and incurred $0.1 million in direct costs (legal and professional services) to complete the transaction.

Insignia Solutions, plc.

On April 4, 2007, the Company, IS Acquisition Sub, Inc., a wholly-owned subsidiary of the Company, and Insignia Solutions, plc and its subsidiaries Insignia Solutions Inc., Insignia Solutions AB and Insignia Asia Corporation (collectively Insignia) entered into an Amendment (the Amendment) to the Asset Purchase Agreement dated February 11, 2007 by and among the Company, Acquisition Sub and Insignia (the Asset Purchase Agreement).

Pursuant to the Asset Purchase Agreement, as amended by the Amendment, the Company, Acquisition Sub and Insignia agreed that, among other things, the aggregate consideration to be paid by the Company under the Asset Purchase Agreement would be $18.8 million, consisting of: $14.5 million in cash; forgiveness of all indebtedness payable by Insignia under the Promissory Note initially delivered to the Company on December 22, 2006 (the principal amount of the note was $0.8 million as of December 31, 2006 and was included in Accounts Receivable on the Consolidated Balance Sheet, and was $2.0 million at the closing of the acquisition), and a cash sum equal to the product of $2.6 million less the dollar amount of the Employee Liabilities (as defined in the Amendment) assumed by the Company at closing.

In accordance with the Asset Purchase Agreement, the Company held back $1.5 million in cash from the aggregate purchase price for twelve months as security for satisfaction of Insignia s indemnification obligations under the Asset Purchase Agreement. In the quarter ended March 31, 2008, the Company filed an indemnification claim against Insignia and demanded that the full amount of the holdback payment be cancelled in partial satisfaction of Insignia s indemnification obligations. In June, 2008 the Company received $0.5 million in settlement of the Company s indemnification claim and was relieved from any obligation to pay the $1.5 million holdback. This payment has been accounted for as a reduction of the purchase price and has been credited to Goodwill. A total of $0.7 million in direct cost (legal and professional services) were incurred relating to this transaction.

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).

SFAS 123(R)

Effective January 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment,* which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including stock options based on their fair values. SFAS No. 123(R) supersedes Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, which the Company previously followed in accounting for stock-based awards. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107 to provide guidance on SFAS No. 123(R). The Company has applied SAB No. 107 in its adoption of SFAS No. 123(R).

The Company adopted SFAS No. 123(R) using the modified prospective transition method as of January 1, 2006. In accordance with the modified prospective transition method, the Company s financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Share-based compensation expense recognized is based on the value of the portion of share-based payment awards that is ultimately expected to vest. Share-based compensation expense recognized in the Company s consolidated statement of operations during the three months ended March 31, 2009 and 2008 includes compensation expense for share-based payment awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 123.

Valuation of Stock Option and Restricted Stock Awards

There were no stock options granted during the three months ended March 31, 2009. The weighted average grant-date fair value of stock options granted during the three months ended March 31, 2008 was $4.07. The assumptions used to compute the share-based compensation costs for the stock options granted during the three months ended March 31, 2008, using the Black-Scholes option pricing model, were as follows:

	Three Months Ended March 31, 2008 (unaudited)
Employee Stock Options	
Risk-free interest rate	2.9%
Expected dividend yield	
Weighted average expected life (years)	4
Volatility	71.0%
Forfeiture rate	3.5%

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

Grants of restricted stock are valued using the closing stock price on the date of grant. In the three months ended March 31, 2009, a total of 50,000 shares of restricted stock, with a total value of $0.2 million, were granted to members of the Board of Directors. This cost will be amortized over a period of 12 months. In addition, 0.8 million shares of restricted stock, with a total value of $3.1 million, were granted to key officers and employees of the Company. This cost will be amortized over a period of 48 months.

Compensation Costs

In conjunction with the adoption of SFAS No. 123(R), the Company elected to attribute the value of share-based compensation to expense using the straight-line method over the requisite service period for each award, which was previously used for its pro forma information required under SFAS No. 123. Share-based non-cash compensation expenses related to stock options and restricted stock grants were recorded in the financial statements as follows (in thousands):

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	Three Months Ended March 31, (unaudited)	
	2009	2008
Cost of revenues	$ 73	$ 100
Selling and marketing	679	1,287
Research and development	607	767
General and administrative	1,015	1,185
Total non-cash stock compensation expense	$ 2,374	$ 3,339

Total share-based compensation for each quarter includes cash payment of income taxes related to grants of restricted stock in the amount of $0.2 million in the three months ended March 31, 2009 and $0.3 million in the three months ended March 31, 2008.

Stock Options

A summary of the Company s stock options outstanding under the 2005 Plan as of March 31, 2009, and the activity during the three months then ended, are as follows:

	Shares	**Weighted Ave. Exercise Price**	**Aggregate Intrinsic Value**
	(in thousands except per share amounts)		
Outstanding as of December 31, 2008	4,289	$ 10.94	
Granted (unaudited)		$	
Exercised (unaudited)	(17)	$ 1.91	
Cancelled (unaudited)	(220)	$ 12.66	
Outstanding as of March 31, 2009 (unaudited)	4,052	$ 10.80	$
Exercisable as of March 31, 2009 (unaudited)	2,622	$ 9.34	$

During the three months ended March 31, 2009 options to acquire 17,000 shares were exercised with an intrinsic value of $57,000, resulting in cash proceeds to the Company of $33,000. There were no stock options granted during the three months ended March 31, 2009. For the quarter ended March 31, 2009, there were $9.5 million of total unrecognized compensation costs related to non-vested stock options granted under the Plan, which will be recognized over a period not to exceed four years. At March 31, 2009, there were 1.4 million shares available for future grants under the 2005 Stock Issuance / Stock Option Plan.

Additional information regarding options outstanding as of March 31, 2009 is as follows:

	Options outstanding			**Options exercisable**	
Range of exercise prices	**Number outstanding (in thousands)**	**Weighted average remaining contractual life (years)**	**Weighted average exercise price**	**Number exercisable (in thousands)**	**Weighted average exercise price**

$0.24 - $4.00	315	4.8	$ 1.68	315	$ 1.68
$4.01 - $6.00	953	6.3	$ 4.95	859	$ 4.95
$6.01 - $12.00	292	7.7	$ 8.73	185	$ 8.60
$12.01 - $14.00	1,310	7.9	$12.68	689	$12.69
$14.01 - $16.00	678	8.0	$15.18	346	$15.19
$16.01 - $19.00	504	8.1	$18.02	228	$18.11