SMITH MICRO SOFTWARE INC
Form 10-Q
August 14, 2017

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 June 30, 2017

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	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 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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of August 4, 2017, there were 14,297,018 shares of common stock outstanding

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SMITH MICRO SOFTWARE, INC.

QUARTERLY REPORT ON FORM 10-Q

June 30, 2017

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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)

	June 30, 2017 (unaudited)	December 31, 2016 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 2,377	$ 2,229
Accounts receivable, net of allowances for doubtful accounts and other adjustments of $59 (2017) and $197 (2016)	4,711	4,962
Income tax receivable	1	1
Inventories, net of reserves for excess and obsolete inventory of $147 (2017) and $148 (2016)	13	12
Prepaid expenses and other current assets	751	713
Total current assets	7,853	7,917
Equipment and improvements, net	1,542	1,811
Other assets	146	149
Intangible assets, net	616	745
Goodwill	3,685	3,686
Total assets	$ 13,842	$ 14,308
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 1,296	$ 1,907
Accrued liabilities	3,212	3,503
Related-party notes payable, short-term	2,000	—
Deferred revenue	568	98
Total current liabilities	7,076	5,508
Non-current liabilities:		
Related-party notes payable, net of discount & issuance costs of $842 (2017) and $1,033 (2016)	1,158	967
Notes payable, net of discount & issuance costs of $842 (2017) and $1,033 (2016)	1,158	967
Warrant liability	1,063	1,210
Deferred rent and other long-term liabilities	2,738	2,971
Deferred tax liability, net	181	181
Total non-current liabilities	6,298	6,296
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; 100,000,000 shares authorized; 14,297,018 and 12,297,954 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	14	12
Additional paid-in capital	230,657	227,889
Accumulated comprehensive deficit	(230,203)	(225,397)
Total stockholders’ equity	468	2,504
Total liabilities and stockholders' equity	$ 13,842	$ 14,308

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(in thousands, except per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017 (unaudited)	2016 (unaudited)	2017 (unaudited)	2016 (unaudited)
Revenues	$5,862	$ 7,459	$11,438	$ 14,673
Cost of revenues	1,285	1,913	2,568	4,026
Gross profit	4,577	5,546	8,870	10,647
Operating expenses:				
Selling and marketing	1,461	2,478	3,254	4,848
Research and development	2,174	4,107	4,671	8,030
General and administrative	2,239	2,870	4,428	5,356
Restructuring expense	322	—	714	—
Total operating expenses	6,196	9,455	13,067	18,234
Operating loss	(1,619)	(3,909)	(4,197)	(7,587)
Other expense:				
Change in fair value of warrant liability	(561)	—	147	—
Change in carrying value of contingent liability	—	657	—	657
Interest (expense) income, net	(390)	(2)	(734)	—
Other expense	1	(15)	(9)	(19)
Loss before provision for income taxes	(2,569)	(3,269)	(4,793)	(6,949)
Provision for income tax expense	5	11	13	37
Net loss	(2,574)	(3,280)	(4,806)	(6,986)
Other comprehensive income, before tax:				
Unrealized holding gains on available-for-sale securities	—	—	—	2
Other comprehensive income, net of tax	—	—	—	2
Comprehensive loss	(2,574)	(3,280)	(4,806)	(6,984)
Net loss per share:				
Basic and diluted	$(0.20)	$ (0.28)	$(0.38)	$ (0.60)
Weighted average shares outstanding:				
Basic and diluted	13,179	11,741	12,674	11,632

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	Amount	Additional paid-in capital	Accumulated comprehensive deficit	Total
BALANCE, December 31, 2016 (audited)	12,298	$ 12	$ 227,889	$ (225,397)	$ 2,504
Shares issued in common stock offering, net	2,162	2	1,990	—	1,992
Common stock warrants issued in connection with stock offering	—	—	64	—	64
Non-cash compensation recognized on stock options and Employee stock purchase plan ("ESPP")	—	—	23	—	23
Restricted stock grants, net of cancellations	(70)	—	811	—	811
Cancellation of shares for payment of withholding tax	(95)	—	(122)	—	(122)
Employee stock purchase plan	2	—	2	—	2
Comprehensive loss	—	—	—	(4,806)	(4,806)
BALANCE, June 30, 2017 (unaudited)	14,297	$ 14	$ 230,657	$ (230,203)	$ 468

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the Six Months Ended June 30,	
	2017 (unaudited)	2016 (unaudited)
Operating activities:		
Net loss	$(4,806)	$ (6,986)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	463	779
Amortization of debt discounts and financing issuance costs	382	—
Change in fair value of warrant liability	(147)	—
Change in carrying value of contingent liability	—	(657)
Provision for doubtful accounts and other adjustments to accounts receivable	74	—
Provision for excess and obsolete inventory	—	4
(Gain) loss on disposal of fixed assets	(6)	18
Stock based compensation	834	765
Change in operating accounts:		
Accounts receivable	177	2,800
Income tax receivable	—	98
Inventories	(1)	11
Prepaid expenses and other assets	(34)	(212)
Accounts payable and accrued liabilities	(1,253)	(460)
Deferred revenue	470	143
Net cash used in operating activities	(3,847)	(3,697)
Investing activities:		
Acquisition of Birdstep Technology, net of cash received	—	(1,927)
Capital expenditures	(63)	(152)
Proceeds from the sale of short-term investments	—	3,360
Net cash (used in) provided by investing activities	(63)	1,281
Financing activities:		
Cash received from stock sale for employee stock purchase plan	2	7
Cash received from stock offering, net of expenses	2,056	—
Cash received from related-party notes payable	2,000	—
Net cash provided by financing activities	4,058	7
Net increase (decrease) in cash and cash equivalents	148	(2,409)
Cash and cash equivalents, beginning of period	2,229	8,819
Cash and cash equivalents, end of period	$2,377	$ 6,410
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	$5	$ 32
Cash paid for interest expense	331	—

Non-cash investing and financing activities:		
Issuance of common stock warrants in connection with stock offering	$64	$ —

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

Notes to the Consolidated Financial Statements

1. The Company

Smith Micro Software, Inc. (“Smith Micro,” “Company,” “we,” “us,” and “or”) develops software to simplify and enhance the mobile experience, providing solutions to leading wireless service providers, device manufacturers, and enterprise businesses around the world. From optimizing wireless networks to uncovering customer experience insights, and from streamlining Wi-Fi access to ensuring family safety, our solutions enrich connected lifestyles, while creating new opportunities to engage consumers via smartphones. Our portfolio also includes a wide range of products for creating, sharing, and monetizing rich content, such as visual messaging, video streaming, and 2D/3D graphics applications. With this as a focus, it is Smith Micro’s mission to help our customers thrive in a connected world.

2. Basis of Presentation

The accompanying interim consolidated balance sheet and statement of stockholders’ equity as of June 30, 2017, and the related consolidated statements of operations and comprehensive loss and cash flows for the three and six months ended June 30, 2017 and 2016, 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, 2016 filed with the SEC.

Intercompany balances and transactions have been eliminated in consolidation.

Operating results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2017.

3. Recently Issued Accounting Pronouncements not yet Adopted

In May 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. The amendments in this ASU provide guidance about which changes to the terms or conditions of share-based payment award require an entity to apply modification accounting in Topic 718. Specifically, an entity should account for the effects of a modification unless all the following are met: (1) The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification; (2) The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3)The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. This ASU is effective for those fiscal years, beginning after December 15, 2017. Early adoption is permitted and should be adopted on a prospective basis. The Company does not expect the adoption of this ASU to have a material impact on our financial statements and related disclosures.

In February 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and other (Topic 350): Simplifying the Test for Goodwill Impairment. Currently, Topic 350 requires an entity to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the entity performs Step 2 and compares the implied fair value of goodwill with the carrying amount of that goodwill for that reporting unit. An impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds the implied fair value of that goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit. To address concerns over the cost and complexity of the two-step goodwill impairment test, the amendments in this Update remove the second step of the test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. A public business entity SEC filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company will be evaluating the impact of this guidance on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, to reduce the existing diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. Amendments in this update are effective for annual periods beginning after December 15, 2017, as well as interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The Company will be evaluating the impact of this guidance on our consolidated financial statements.

In March 2016, the FASB issued final guidance in ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which will change certain aspects of accounting for share-based payments to employees. The new guidance will require all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It will also allow an employer to repurchase more of an employee’s shares than it currently can for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. The guidance is effective for financial statements issued for annual periods beginning after December 15, 2016. Early adoption is permitted for all companies in any interim or annual period and must be adopted on a modified prospective approach. Due to the Company applying a full valuation allowance against its deferred tax assets, the nature of the change on the consolidated financial statements is not material.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. The Company will be evaluating the impact of this guidance on our consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments-Overall (Topic 825-10). The Amendments to this Update require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this Update also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the amendments in this Update requires disclosure of the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early application by public business entities to financial statements of fiscal years or interim periods that have not yet been issued or, by all other entities, that have not yet been made available for issuance of the following amendments in this Update are permitted as of the beginning of the fiscal year of adoption - an entity should present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The Company will be 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. In July 2015, the FASB deferred the effective date for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods). Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company will be evaluating the impact of this guidance on our consolidated financial statements.

4. Going Concern Evaluation

In connection with preparing consolidated financial statements for the three and six months ended June 30, 2017, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about the Company's ability to continue as a going concern within one year from the date that the financial statements are issued.

The Company considered the following:

- Operating losses for ten consecutive quarters
- Negative cash flow from operating activities for six consecutive quarters
- Depressed stock price resulting in being non-compliant with NASDAQ listing rules to maintain a stock price of $1.00/share
- Stockholders' equity being less than $2.5 million at March 31, 2017 and June 30, 2017 resulting in being non-compliant with NASDAQ listing rules

Ordinarily, conditions or events that raise substantial doubt about an entity's ability to continue as a going concern relate to the entity's ability to meet its obligations as they become due.

The Company evaluated its ability to meet its obligations as they become due within one year from the date that the financial statements are issued by considering the following:

- The Company raised $4.0 million of debt financing during the year ended December 31, 2016
- The Company has been able to raise capital from short-term loans from insiders
- As a result of the Company's restructurings that were implemented during the three months ended December 31, 2016, and again during the six months ended June 30, 2017, the Company's cost structure is now in line with its future revenue projections. See Footnote 5 below for additional details regarding restructurings

Management believes that the Company will generate enough cash from operations to satisfy its obligations for the next twelve months.

The Company will take the following actions, if it starts to trend unfavorable to its internal profitability and cash flow projections, in order to mitigate conditions or events that would raise substantial doubt about its ability to continue as a going concern:

- Raise additional capital through short-term loans
- Implement additional restructuring and cost reductions
- Raise additional capital through a private placement
- Secure a commercial bank line of credit
- Dispose of one or more product lines
- Sell or license intellectual property

5. Restructuring

2017 Restructuring

In the first quarter of fiscal 2017, the Board of Directors reviewed an additional restructuring plan intended to further streamline and flatten the Company's organization, reduce overall headcount by approximately 16%, and reduce its overall cost structure by another $0.9 - $1.0 million per quarter. The restructuring plan resulted in special charges totaling $0.7 million recorded during the six-month period ending June 30, 2017. These charges were primarily related to severance costs and included $0.4 million of non-cash stock-based compensation severance.

2016 Restructuring

In the fourth quarter of fiscal 2016, the Board of Directors approved a plan of restructurings intended to streamline and flatten the Company’s organization, reduce overall headcount by approximately 30%, and reduce its overall cost structure by approximately $2.5

million per quarter. The restructuring plan resulted in special charges totaling $0.3 million recorded during the three-month period ended December 31, 2016. These charges were primarily related to severance costs and were all paid out by December 31, 2016.

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.

2013 Restructuring

On July 25, 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 resulting in annualized savings of approximately $16.0 million. The restructuring plan resulted in special charges totaling $5.6 million recorded in the year ended December 31, 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.

In the year ended December 31, 2014, we increased the reserve by $0.6 million due to changes in our assumptions on future sublease income on our lease terminations of $0.8 million, partially offset by adjustments to our one-time employee termination benefits.

Following is the activity in our restructuring liability for the six months ended June 30, 2017 (in thousands):

	December 31, 2016 Balance	Provision-net	Usage	June 30, 2017 Balance
Lease/rental terminations	$ 1,786	$ (3)	$ (170)	$ 1,613
One-time employee termination benefits	65	805	(574)	296
Datacenter consolidation, other	109	(93)	(16)	—
Total	$ 1,960	$ 709	$ (760)	$ 1,909

Of the total $1.9 million balance, $0.6 million is reported in Accrued liabilities and $1.3 million is reported in Deferred rent and other long-term liabilities on the balance sheet.

6. Net Loss Per Share

The Company calculates earnings per share (“EPS”) as required by FASB 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, options, and warrants are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

On August 15, 2016, the Company filed a Certificate of Amendment to its Amended and Restated Certificate of Incorporation with the Secretary of State of Delaware for the purpose of effecting a reverse stock split (the "Reverse Split") of the outstanding shares of the Company's common stock at a ratio of one (1) share for every four (4) shares outstanding, so that every four (4) outstanding shares of common stock before the Reverse Split represents one (1) share of common stock after the Reverse Split. Proportionate adjustments were made to: (i) the aggregate number of shares of Common Stock available for equity-based awards to be granted in the future under our 2015 Omnibus Equity Incentive Plan; (ii) the number of shares that would be owned upon vesting of restricted stock awards and stock options which are outstanding under our 2015 Omnibus Equity Incentive Plan and 2005 Stock Option Plan, and the exercise price of any outstanding stock options, and (iii) the number of shares of Common Stock available for purchase under our Preferred Shares Rights Agreement, dated October 16, 2015, between us and Computershare Trust Company, N.A., as rights agent. We have a total of 100,000,000 authorized shares of common stock which remained unchanged by the reverse stock split. The Reverse Split, which was approved by the Company's stockholders at the special meeting held on August 15, 2016 and was effective on August 17, 2016. The Company adjusted shareholders' equity to reflect the reverse stock split by reclassifying an amount equal to the par value of the additional shares arising from the split from common stock to the Additional Paid-in Capital during the third quarter of fiscal 2016, resulting in no net impact to shareholders' equity on our consolidated balance sheets. Fractional shares were rounded down to the nearest whole share. Stockholders received cash in lieu of such fractional shares. All information presented herein has been retrospectively adjusted to reflect the reverse stock split as if it took place as of the earliest period presented.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
	(unaudited, in thousands, except per share amounts)		(unaudited, in thousands, except per share amounts)	
Numerator:				
Net loss available to common stockholders	$ (2,574)	$ (3,280)	$ (4,806)	$ (6,986)
Denominator:				
Weighted average shares outstanding - basic	13,179	11,741	12,674	11,632
Potential common shares - options / warrants (treasury stock method)	—	—	4	—
Weighted average shares outstanding - diluted	13,179	11,741	12,678	11,632
Shares excluded (anti-dilutive)	—	—	—	—
Shares excluded due to an exercise price greater than weighted average stock price for the period	1,973	368	1,869	368
Net loss per common share:				
Basic	$ (0.20)	$ (0.28)	$ (0.38)	$ (0.60)
Diluted	$ (0.20)	$ (0.28)	$ (0.38)	$ (0.60)

7. Stock-Based Compensation

Stock Plans

During the six months ended June 30, 2017, the Company granted 87,500 shares of restricted stock with a weighted average grant date fair value of $1.11 per share. These costs will be amortized ratably over a period of 0 to 48 months.

As of June 30, 2017, there were 1.7 million shares available for future grants under the 2015 Omnibus Equity Incentive Plan.

Employee Stock Purchase Plan

The Company's most recent six-month offering period ended June 30, 2017 and resulted in 2,002 shares being purchased/granted at a fair value of $0.79 per share. The next six-month offering period began on April 1, 2017 and will end on September 30, 2017. These shares will have a fair value of $0.77 per share.

Stock Compensation

The Company accounts for all stock-based payment awards made to employees and directors based on their fair values, which is 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.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
	(unaudited)		(unaudited)	
Cost of revenues	$—	$—	$—	$2
Selling and marketing	(36)	84	(33)	154
Research and development	46	127	125	248
General and administrative	207	194	344	361
Restructuring expense	171	—	398	—
Total non-cash stock compensation expense	$388	$405	$834	$765

8. Fair Value Measurements

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

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 and cash equivalents at fair value. Our cash equivalents are classified within Level 1 by using quoted market prices utilizing market observable inputs.

As required by FASB ASC Topic No. 820, we measure our warrant liability at fair value. Our warrant liability is classified within Level 3 as some of the inputs to our valuation model are either not observable quoted prices or are not derived principally from or corroborated by observable market data by correlation or other means.

As required by FASB ASC Topic No. 820, we utilize quoted market prices to estimate the fair value of our fixed rate debt, when available. If quoted market prices are not available, we calculate the fair value of our fixed rate debt based on a currently available market rate, assuming the loans are outstanding through maturity and considering the collateral. In determining the current market rate for fixed rate debt, a market spread is added to the quoted yields on federal government treasury securities with similar terms to the debt.

9. Debt and Fair Value of Financial Instruments

The Company analyzes all financial instruments with features of both liabilities and equity under FASB ASC Topic No. 480, Distinguishing Liabilities From Equity and FASB ASC Topic No. 815, Derivatives and Hedging. Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in results of operations as adjustments to fair value of derivatives. The effects of interactions between embedded derivatives are calculated and accounted for in arriving at the overall fair value of the financial instruments. In addition, the fair values of freestanding derivative instruments, such as warrant derivatives are valued using the Black-Scholes model.

At June 30, 2017 and December 31, 2016, the carrying value and the aggregate fair value of the Company's warrant liability and long-term debt were as follows (in thousands):

	As of June 30, 2017		As of December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Liabilities:				
Warrant liability, net	$ 1,063	$ 1,063	$ 1,210	$ 1,210
Long-term debt, net	$ 2,316	$ 2,316	$ 1,934	$ 1,934

The warrants were accounted for as liabilities, with changes in the fair value included in net loss for the respective periods. Because some of the inputs to our valuation model were either not observable nor derived principally from or corroborated by observable market data by correlation or other means, the warrant liability is classified as a Level 3 in the fair value hierarchy.

Our stock price can be volatile and there could be material fluctuations in the value of the warrants in future periods.

A roll forward of our warrant liability classified as Level 3 and measured at fair value on a recurring basis is as follows (in thousands):

Balance, December 31, 2016 (audited)	$ 1,210
Change in fair value of warrant liability	(147)
Balance, June 30, 2017 (unaudited)	$ 1,063

Warrant Liability

On September 2, 2016, we entered into a Note and Warrant Purchase Agreement with Unterberg Koller Capital Fund L.P. and William W. and Dieva L. Smith (collectively, the "Investors"), pursuant to which the Company issued and sold to the Investors in a private placement senior subordinated promissory notes in the aggregate principal amount of $4,000,000 and five-year warrants to purchase an aggregate of 1,700,000 shares of the Company's common stock at an exercise price of $2.74 per share that expire five years from the date of issuance. The Company completed the transactions contemplated by the Purchase Agreement and issued the Notes and Warrants on September 6, 2016. We assessed the warrants and concluded that they should be recorded as a liability.

The initial fair value of the warrant liability associated with the Note and Warrant Purchase Agreement was $2.1 million, and the fair value has decreased to $ 1.1 million as of June 30, 2017.

All changes in the fair value of warrants will be recognized in our consolidated statements of operations until they are either exercised or expire. The warrants are not traded in an active securities market and, as such, the estimated fair value as of June 30, 2017 was determined by using an option pricing model (Black-Scholes) with the following assumptions:

	As of June 30, 2017	
Expected term	4.17	
Common stock market price	$ 1.46	
Risk-free interest rate	1.77	%
Expected volatility	74.7	%
Resulting fair value (per warrant)	$ 0.63	

Expected volatility is based on historical volatility. Historical volatility was computed using monthly pricing observations for recent periods that correspond to the expected term of the warrants. We believe this method produces an estimate that is representative of our expectations of future volatility over the expected term of these warrants. We currently have no reason to believe future volatility over the expected remaining life of these warrants is likely to differ materially from historical volatility. The expected life is based on the remaining contractual term of the warrants. The risk-free interest rate is the U.S. Treasury bond rate as of the valuation date.

Short-Term Debt

On February 7, 2017, the Company entered into a short-term secured borrowing arrangement with William W. and Dieva L. Smith (“Smith”) and on February 8, 2017 entered into a short-term secured borrowing arrangement with Steven L. and Monique P. Elfman (“Elfman”) pursuant to which Smith and Elfman each loaned to the Company $1,000,000 and the Company issued to each of them a Secured Promissory Note (the “Original Notes”) bearing interest at the rate of 18% per annum. The Original Notes were due on

March 24, 2017 and are secured by the Company's accounts receivable and certain other assets. William W. Smith, Jr. is the Company's Chairman of the Board, President and Chief Executive Officer. Steven L. Elfman is a director of the Company.

On March 25, 2017, the Company entered into an Amendment to the Original Note issued to Smith that extended the Maturity Date of the Note to June 26, 2017.

On March 31, 2017, the Company entered into a new short-term secured borrowing arrangement with Elfman for $1,000,000 which matured on June 23, 2017.

On June 30, 2017, the Company entered into a new short-term secured borrowing arrangement with each of Smith and Elfman, to refinance the prior Notes with each of them which matured on June 26, 2017 and June 23, 2017, respectively. Under the new borrowing arrangement, the Company issued to each of Smith and Elfman a new Secured Promissory Note ("Amended Notes") with a principal balance of $1,000,000, bearing interest at the rate of 12% per annum, and maturing on September 25, 2017. The maturity date of the Amended Note entered into with Smith may be extended by up to 180 days upon the mutual consent of the Company and Smith. Each of the Amended Notes are secured by the Company's accounts receivable and certain other assets.

Long-Term Debt

At June 30, 2017, the aggregate fair value and the carrying value of the Company's long-term debt was as follows (in thousands):

	As of June 30, 2017		As of December 31, 2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt - related party	$ 1,158	$ 1,158	$ 967	$ 967
Long-term debt	1,158	1,158	967	967
Total long-term debt	$ 2,316	$ 2,316	$ 1,934	$ 1,934

The carrying value of $2.3 million and $1.9 million are net of debt discount of $1.6 million and $1.9 million and debt issuance costs of $0.1 million and $0.2 million as of June 30, 2017 and December 31, 2016, respectively.

10. Cash and Cash Equivalents

Cash and cash equivalents 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 June 30, 2017 and December 31, 2016, bank balances totaling approximately $2.1 million and $2.1 million, respectively, were uninsured.

11. 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 consolidated balance sheets. Product returns are estimated based on historical experience and management estimations.

The Company is utilizing the accounts receivable balances to secure the related party short term notes payable.

12. 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 June 30, 2017 and June 30, 2016. The Company determined there was an impairment of its Customer Relationships intangible asset in the amount of $0.4 million as of December 31, 2016.

13. 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.

14. Goodwill

In accordance with FASB ASC Topic No. 350, Intangibles-Goodwill and Other, we review the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. The Company’s impairment testing will be done annually at December 31. Recoverability of goodwill is determined by comparing the fair value of the Company’s reporting units to the carrying value of the underlying net assets in the reporting units. If the fair value of a reporting unit is determined to be less than the carrying value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the fair value of the reporting unit and the fair value of its other assets and liabilities. The Company determined that there was no goodwill impairment at June 30, 2017 and December 31, 2016.

15. Intangible Assets

The following table sets forth our acquired intangible assets by major asset class as of June 30, 2017 and December 31, 2016 (in thousands except for useful life data):

		June 30, 2017			December 31, 2016				
	Useful life (years)	Gross	Accumulated amortization	Net book value	Gross	Accumulated amortization	Net book value before impairment	Impairment charge	Net book value
Purchased technology	5-6	$265	$ (54)	$ 211	$265	$ (32)	$ 233	$ —	$ 233
Customer relationships	3-6	528	(176)	352	999	(147)	852	(411)	441
Trademarks/trade names	2	38	(19)	19	38	(9)	29	—	29
Non-compete	3	51	(17)	34	51	(9)	42	—	42
Total		$882	$ (266)	$ 616	$1,353	$ (197)	$ 1,156	$ (411)	$ 745

Intangible assets amortization expense was $0.1 million for the three and six months ended June 30, 2017, respectively, and $0 for the three and six months ended June 30, 2016, respectively.

Future amortization expense related to intangible assets as of June 30, 2017 are as follows (in thousands):

Year Ending December 31,	
2017 - 6 months remaining	$129
2018	249
2019	143
2020	47
2021	40
Beyond	8
Total	$616

16. 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 NetWise®, CommSuite®, SafePath™, and QuickLink® family of products. Graphics includes our consumer-based products: Poser®, Moho™, ClipStudio®, 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.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
	(unaudited)		(unaudited)	
Wireless	$4,629	$6,303	$8,988	$12,276
Graphics	1,233	1,156	2,450	2,397
Total revenues	$5,862	$7,459	$11,438	$14,673

Customer Concentration Information

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
	(unaudited)		(unaudited)	
Wireless:				
Sprint (& affiliates)	61.8%	64.6%	60.6%	64.8%
Graphics:				
FastSpring	15.6%	11.1%	14.8%	12.3%

The two customers listed above comprised 76% and 81% our accounts receivable as of June 30, 2017 and 2016, respectively.

Geographical Information

During the three months ended June 30, 2017 and 2016, 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 customers' bill-to address, were as follows (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
	(unaudited)		(unaudited)	
Americas	$5,763	$7,302	$11,236	$14,444
EMEA	31	103	81	164
Asia Pacific	68	54	121	65
Total revenues	$5,862	$7,459	$11,438	$14,673

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

17. Related-Party Transactions

On September 2, 2016, the Company entered into a Note and Warrant Purchase Agreement (the "Purchase Agreement") with William W. and Dieva L. Smith (collectively, the "Investors"), pursuant to which the Company issued and sold to the Investors in a private placement senior subordinated promissory notes in the aggregate principal amount of

$2,000,000 (the "Debt Notes") and five-year warrants (the "Warrants") to purchase an aggregate of 850,000 shares of the Company's common stock at an exercise price of $2.74 per share. The Company completed the transactions contemplated by the Purchase Agreement and issued the Debt Notes and Warrants on September 6, 2016. William W. Smith, Jr. is the Company's Chairman of the Board, President and Chief Executive Officer. Refer to Note 19 Long Term Debt below for additional details.

On February 7, 2017, the Company entered into a short-term secured borrowing arrangement with William W. and Dieva L. Smith ("Smith") and on February 8, 2017 entered into a short-term secured borrowing arrangement with Steven L. and Monique P. Elfman ("Elfman") pursuant to which Smith and Elfman each loaned to the Company $1,000,000 and the Company issued to each of them a Secured Promissory Note (the "Original Notes") bearing interest at the rate of 18% per annum. The Original Notes were due on March 24, 2017 are secured by the Company's accounts receivable and certain other assets. Steven L. Elfman is a director of the Company.

On March 25, 2017, the Company entered into an Amendment to the Original Note issued to Smith that extended the Maturity Date of the Note to June 26, 2017.

On March 31, 2017, the Company entered into a new short-term secured borrowing arrangement with Elfman for $1,000,000 which matured on June 23, 2017.

On June 30, 2017, the Company entered into a new short-term secured borrowing arrangement with each Smith and Elfman to refinance the prior with each of them which matured on June 26, 2017 and June 23, 2017, respectively. Under the new borrowing arrangement, the Company issued to each of Smith and Elfman a new Secured Promissory Note ("Amended Notes") with a principal balance of $1,000,000, bearing interest at the rate of 12% per annum, and maturing on September 25, 2017. The maturity date of the

Amended Note entered into with Smith may be extended by up to 180 days upon the mutual consent of the Company and Smith. Each of the Amended Notes are secured by the Company's accounts receivable and certain other assets.

On May 16, 2017, the Company entered into subscription agreement with Andrew Arno in a private placement pursuant to which the Company issued and sold 50,000 shares of its common stock at a price per share of $1.10. Andrew Arno is a director of the Company.

18. Commitments and Contingencies

Leases

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 June 30, 2017 are as follows (in thousands):

Year Ending December 31,	Operating
2017 - 6 months remaining	$ 1,194
2018	2,417
2019	2,020
2020	1,719
2021	1,721
2022	33
Total	$ 9,104

As of June 30, 2017, $3.6 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 $1.9 million.

Rent expense under operating leases was $0.6 million and $0.5 million for the three months ended June 30, 2017 and 2016, respectively. Rent expense under operating leases was $1.0 million and $0.8 million for the six months ended June 30, 2017 and 2016, 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 19, 2016, we entered into a Settlement and Release Agreement with the Commonwealth of Pennsylvania, acting by and through the Department of Community and Economic Development ("DCED") to repay $0.3 million of the original $1.0 million grant. Per the agreement, the total amount due of $0.3 million is at 0% interest and is payable in twenty equal quarterly installments commencing on January 31, 2017 and ending on October 31, 2021. The balances were $0.3 million as of June 30, 2017 and December 31, 2016 and are reported in Accrued liabilities and Deferred rent and other long-term liabilities on the balance sheet.

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 its normal course of business, the Company has made certain indemnities, commitments, and guarantees under which it may be required to make payments in relation to certain transactions. These include: intellectual property indemnities to the Company's customers and licensees in connection with the use, sale, and/or license of Company 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 of the Company; indemnities involving the accuracy of representations and warranties in certain contracts; and, indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware. In addition, the Company has made contractual commitments to employees providing for severance payments upon the occurrence of certain prescribed events. The Company 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 the Company could be obligated to make. The Company has not recorded any liability for these indemnities, commitments, and guarantees in the accompanying consolidated balance sheets.

19. Long Term Debt

On September 2, 2016, the Company entered into a Note and Warrant Purchase Agreement (the "Purchase Agreement") with Unterberg Koller Capital Fund L.P. and William W. and Dieva L. Smith (collectively, the "Investors"), pursuant to which the Company issued and sold to the Investors in a private placement senior subordinated promissory notes in the aggregate principal amount of $4,000,000 (the "Debt Notes") and five-year warrants (the "Warrants") to purchase an aggregate of 1,700,000 shares of the Company's common stock (the "Warrant Shares") at an exercise price of $2.74 per share. The Company completed the transactions contemplated by the Purchase Agreement and issued the Notes and Warrants on September 6, 2016.

The Debt Notes mature three years following the issuance date, or September 6, 2019, and bear interest at the rate of 10% of the outstanding principal balance of the Debt Notes, payable quarterly in cash or shares of the Company's common stock at a conversion price equal to the greater of (i) the five-day volume weighted average closing price of the common stock on the Nasdaq Stock Market, measured on the third trading day prior to the date that interest is due, or, (ii) the minimum price so that payment of interest for such installment in the form of common stock shall not constitute "equity compensation" to an officer, director, employee or consultant of the Company for purposes of Rule 5635(c) of the Nasdaq Stock Market or a private placement that, combined with the other securities issued or issuable under the Purchase Agreement, would require shareholder approval by the Company under Rule 5635(d) of the Nasdaq Stock Market. The Debt Notes are subordinate and junior in right of payment to the prior payment in full of all claims, whether now existing or arising in the future, of holders of senior debt of the Company, as described in the Debt Notes.

Under the Debt Notes, if an Acceleration Event occurs and shall be continuing, any Holder of the Debt Notes may by written notice delivered to the Secretary of the Company within ninety days after any occurrence of such Acceleration Event (an "Acceleration Notice") declare the entire unpaid principal balance of the Debt Note, together with all interest accrued, due and payable without presentment, demand, protest, or notice (except for the delivery of an Acceleration Notice). For purposes of the Debt Notes, an Acceleration Event shall occur if, while the Debt Notes are outstanding, William W. Smith, Jr. (i) is not nominated for re-election as a director of the Company at the normal expiration of his term as director, (ii) is terminated or removed as Chairman of the Board of Directors of the Company, (iii) is terminated or removed as Chief Executive Officer of the Company, or (iv) dies or becomes permanently disabled. An Acceleration Event shall not occur if Mr. Smith consents to any of the events referenced above or voluntarily resigns or retires from any of the positions listed.

We allocated the aggregate proceeds of the senior subordinated promissory notes payable between the warrants and the debt obligations based on their fair values. In accordance with FASB ASC Topics 480 and 815, the warrants were recorded as a liability and are marked to market at each reporting end. The fair value of the warrants was calculated utilizing the Black-Scholes option pricing model. The Black-Scholes option-pricing model incorporates various and highly sensitive assumptions, including expected volatility, expected term, and risk-free interest rates. The expected volatility is based on the historical volatility of the Company's common stock over the most recent period. The risk-free interest rate for the period within the contractual life of the warrant is based on the U.S. Treasury yield in effect at the time of grant. We are amortizing the fair value of the warrants as a discount of $2.1 million over the term of the loan using the effective interest method, with an effective interest rate of 28.4%.

20. Equity Transactions

On May 16, 2017, the Company entered into subscription agreements with several investors for the issuance and sale of an aggregate of 2,077,000 shares of its common stock, in a registered direct offering at a purchase price of $1.05 per share. The Shares were offered by the Company pursuant to a shelf registration statement on Form S-3 (File No. 333-215786), which was declared effective on February 10, 2017 by the Securities and Exchange Commission (the “SEC”). Also, on May 16, 2017, the Company entered into subscription agreements with four accredited investors in a private placement pursuant to which the Company issued and sold to the Investors an aggregate of 85,000 shares of its unregistered common stock at a price per share of $1.10.

The Company engaged Sutter Securities Incorporated and Chardan Capital Markets, LLC as co-placement agents in connection with the registered direct offering pursuant to engagement letter agreements with each firm. The Company agreed to pay the placement agents a cash placement fee and issued to the placement agents warrants to purchase shares of Common Stock equal to 5% of the number of shares sold through each of them, without duplication, at an exercise price per share equal to $1.21 (Sutter) and $1.155 (Chardan). The warrants have a term of five years and will be exercisable beginning on November 18, 2017.

The transactions closed on May 17, 2017 and the Company realized gross proceeds of $2.3 million before deducting transaction fees and other expenses. Offering costs related to the transaction totaled $0.2 million, comprised of $0.1 million of transaction fees and $0.1 million of legal and other expenses, resulting in net proceeds of $2.1 million.

21. 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 income tax 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 liabilities against gross deferred tax assets); (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 five-year historical cumulative loss as of the end of fiscal year 2016. 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, 2016 (as described above), and after consideration of the Company's continuing cumulative loss position as of December 31, 2016, the Company will continue to reserve its US-based deferred tax amounts, which total $76.3 million, as of June 30, 2017.

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 – 2015 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 consolidated financial results. It is the Company's policy to classify any interest and/or penalties in the consolidated financial statements as a component of income tax expense.

22. Subsequent Events

The Company evaluates and discloses subsequent events as required by FASB 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.

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 our ability to remain a going concern, our ability to raise more funds, customer concentration, projected revenues, expenses, gross profit and income, the competitive factors affecting our business, market acceptance of products, 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 sim 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:

- we may not be able to remain a going concern;
- we may not be able 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;
- we may not be able to become and remain profitable;
- 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;
- changes in demand for our products from our key customers and their end users;
- the intensity of the competition and our ability to successfully compete;
- the pace at which the market for new products develop;
- 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 establish and maintain strategic relationships with our customers;
- our ability to assimilate acquisitions without diverting management attention and impacting current operations;
- our ability to protect our intellectual property and our ability to not infringe on the rights of others;
- 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,
- the risk of being delisted from NASDAQ if we fail to meet any of the listing requirements.

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.

Overview

Smith Micro develops software to simplify and enhance the mobile experience, providing solutions to leading wireless service providers, device manufacturers, and enterprise businesses around the world. From optimizing wireless networks to uncovering customer experience insights, and from streamlining Wi-Fi access to ensuring family safety, our solutions enrich connected lifestyles while creating new opportunities to engage consumers via smartphones. Our portfolio also includes a wide range of products for creating, sharing, and monetizing rich content, such as visual messaging, video streaming, and 2D/3D graphics applications. With this as a focus, it is Smith Micro's mission to help our customers thrive in a connected world.

Over the past three decades, Smith Micro has developed deep expertise in embedded software for mobile devices, policy-based management platforms, and highly-scalable client and server applications. Tier 1 mobile network operators, cable providers, OEMs/device manufacturers, and enterprise businesses across a wide range of industries use our software to capitalize on the growth of connected consumers and the Internet of Things ("IoT").

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Wireless:				
Sprint (& affiliates)	61.8 %	64.6 %	60.6 %	64.8 %
Graphics:				
FastSpring	15.6 %	11.1 %	14.8 %	12.3 %

The two customers listed above comprised 76% and 81% our accounts receivable as of June 30, 2017 and 2016, respectively.

Results of Operations

The table below sets forth certain statements of operations and comprehensive loss data expressed as a percentage of revenues for the three and six months ended June 30, 2017 and 2016. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenues	21.9	25.6	22.5	27.4
Gross profit	78.1	74.4	77.5	72.6
Operating expenses:				
Selling and marketing	24.9	33.2	28.5	33.1
Research and development	37.1	55.1	40.8	54.7
General and administrative	38.2	38.5	38.7	36.5
Restructuring expense	5.5	0.0	6.2	0.0
Total operating expenses	105.7	126.8	114.2	124.3
Operating loss	(27.6)	(52.4)	(36.7)	(51.7)
Change in fair value of warrant liability	(9.5)	—	1.3	—
Change in carrying value of contingent liability	—	8.8	—	4.5

Interest income (expense), net	(6.7)	—	(6.4)	—
Other expense	—	(0.2)	(0.1)	(0.1)
Loss before provision for income taxes	(43.8)	(43.8)	(41.9)	(47.3)
Provision for income tax expense	0.1	0.2	0.1	0.3
Net loss	(43.9)%	(44.0)%	(42.0)%	(47.6)%

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 NetWise®, CommSuite®, SafePath™, and QuickLink®, family of products; and,
- Graphics, which includes our consumer-based products: Poser®, Moho™, ClipStudio®, MotionArtist®, and StuffIt®.

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2017	2016	2017	2016
Wireless	$4,629	$6,303	$8,988	$12,276
Graphics	1,233	1,156	2,450	2,397
Total revenues	5,862	7,459	11,438	14,673
Cost of revenues	1,285	1,913	2,568	4,026
Gross profit	$4,577	$5,546	$8,870	$10,647

Cost of revenues. Cost of revenues consists of direct product and assembly, maintenance, data center, royalties, and technical support expenses.

Selling and marketing. Selling and marketing expenses consist primarily of personnel costs, advertising costs, sales commissions, trade show expenses, and the amortization of certain intangible assets. 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. It also includes the amortization of certain intangible assets.

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 expenses consist primarily of one-time employee termination benefits, lease and other contract terminations, costs to consolidate facilities, and other related costs.

Change in fair value of warrant liability. The change in the fair value of our warrant liability.

Interest income (expense), net. Interest income (expense), net is primarily related to interest on our debt, and the credit-adjusted risk-free interest rate used to measure our operating lease termination liabilities in restructuring.

Other expense. Other expense is primarily related to fixed assets disposals.

Provision for income tax expense. The Company accounts for income taxes as required by FASB 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. The current provision for income tax expense consists of state income tax minimums, foreign tax withholdings, and foreign income taxes

Three Months Ended June 30, 2017 Compared to the Three Months Ended June 30, 2016

Revenues. Revenues were $5.9 million and $7.5 million for the three months ended June 30, 2017 and 2016, respectively, representing a decrease of $1.6 million, or 21%. Wireless revenue of $4.6 million decreased $1.7 million, or 27%, primarily due to decreases with Sprint of $1.3 million and decreases in our legacy businesses of $0.4 million. Graphics revenue increased by 0.1 million or 7% over last year. We continue to invest in new products purchased through the 2016 acquisitions and pursue related opportunities.

Cost of revenues. Cost of revenues were $1.3 million and $1.9 million for the three months ended June 30, 2017 and 2016, respectively, representing a decrease of $0.6 million, or 33%. This decrease was primarily due to lower sales and cost reductions.

Gross profit. Gross profit was $4.6 million, or 78% of revenues for the three months ended June 30, 2017, a decrease of $0.9 million, or 18%, from $5.5 million, or 74% of revenues for the three months ended June 30, 2016. The percentage point increase was primarily due to cost reductions.

Selling and marketing. Selling and marketing expenses were $1.5 million and $2.5 million for the three months ended June 30, 2017 and 2016, respectively, representing a decrease of $1.0 million, or 41%. This decrease was primarily due to headcount and other cost reductions due to our recent restructurings. The amortization of intangibles assets was $0.1 million for the period ended June 30, 2017. Stock-based compensation was essentially zero and $0.1 million for the three months ended June 30, 2017 and 2016, respectively, representing a decrease of $0.1 million.

Research and development. Research and development expenses were $2.2 million and $4.1 million for the three months ended June 30, 2017 and 2016, respectively, representing a decrease of $1.9 million, or 47%. This decrease was primarily due to headcount and other cost reductions due to our recent restructurings. Stock-based compensation was essentially zero and $0.1 million for the three months ended June 30, 2017 and 2016, respectively.

General and administrative. General and administrative expenses were $2.2 million and $2.9 million for the three months ended June 30, 2017 and 2016, respectively, representing a decrease of $0.7 million, or 22%. The decrease was primarily due to lower depreciation expense and a reduction of professional service costs. Stock-based compensation remained flat at $0.2 million for both of the three months ended June 30, 2017 and 2016, respectively.

Restructuring expense. Restructuring expense was $0.3 million and $0 for the three months ended June 30, 2017 and 2016, respectively. The 2017 expense was primarily due to one-time employee terminations of $0.1 million and the acceleration of stock awards vesting of $0.2 million.

Change in fair value of warrant liability. The change in the fair value of the warrant liability was $0.6 million and $0 for the three months ended June 30, 2017 and 2016, respectively.

Change in carrying value of contingent liability. The change in the carrying value of contingent liability was $0 and $0.7 million for the three months ended June 30, 2017 and 2016, respectively. This results from a change in the carrying value of our $1 million Pennsylvania Grant received by setting up a new facility in that State.

Interest (expense) income, net. Interest expense was $0.4 million for the three months ended June 30, 2017, interest on notes payable of $0.2 million and amortization of the debt discount and issuance costs was $0.2 million. Interest expense was $2,000 for the three months ended June 30, 2016.

Six Months Ended June 30, 2017 Compared to the Six Months Ended June 30, 2016

Revenues. Revenues were $11.4 million and $14.7 million for the six months ended June 30, 2017 and 2016, respectively, representing a decrease of $3.3 million, or 22%. Wireless revenues decreased $3.3 million, or 27%, primarily due to decreases with Sprint. Graphics revenues were essentially flat. We continue to invest in new products purchased through the 2016 acquisitions and pursue related opportunities.

Cost of revenues. Cost of revenues was $2.6 million and $4.0 million for the six months ended June 30, 2017 and 2016, respectively, representing a decrease of $1.4 million, or 36%. This decrease was primarily due to lower sales and cost reductions.

Gross profit. Gross profit was $8.9 million, or 78% of revenues for the six months ended June 30, 2017, a decrease of $1.7 million, or 17%, from $10.6 million, or 73% of revenues for the six months ended June 30, 2016. The percentage point increase was primarily due to the lower revenues.

Selling and marketing. Selling and marketing expenses were $3.2 million and $4.8 million for the six months ended June 30, 2017 and 2016, respectively, representing a decrease of $1.6 million, or 33%. This decrease was primarily due to headcount reductions due to our recent restructurings. Stock-based compensation was zero and $0.2 million for the six months ended June 30, 2017 and 2016, respectively.

Research and development. Research and development expenses were $4.7 million and $8.0 million for the six months ended June 30, 2017 and 2016, respectively, representing a decrease of $3.3 million, or 42%. This decrease was primarily due to headcount reductions and a reduction of consulting service costs. Stock-based compensation decreased from $0.2 million to $0.1 million, or $0.1 million for the six months ended June 30, 2017 and 2016, respectively.

General and administrative. General and administrative expenses were $4.4 million and $5.3 million for the six months ended June 30, 2017 and 2016, respectively, representing a decrease of $0.9 million, or 17%. This decrease was primarily due to lower travel related costs and professional service fees. Stock-based compensation was $0.3 million and $0.4 million for the six months ended June 30, 2017 and 2016, respectively.

Restructuring expense. Restructuring expense was $0.7 million and $0 for the six months ended June 30, 2017 and 2016, respectively. The 2017 expense was primarily due to employee terminations and the acceleration of stock awards vesting.

Change in fair value of warrant liability. The change in the fair value of the warrant liability was $0.1 million and $0 for the six months ended June 30, 2017 and 2016, respectively.

Change in carrying value of contingent liability. This consists of the amount earned from our $1 million Pennsylvania Grant received by setting up a new facility in that State.

Liquidity and Capital Resources

Going Concern Evaluation

In connection with preparing consolidated financial statements for the three months ended June 30, 2017, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about the Company's ability to continue as a going concern within one year from the date that the financial statements are issued.

The Company considered the following:

- Operating losses for ten consecutive quarters.
- Negative cash flow from operating activities for six consecutive quarters.
- Depressed stock price resulting in being non-compliant with NASDAQ listing rules to maintain a stock price of $1.00/share.
- Stockholders' equity being less than $2.5 million at March 31, 2017 and June 30, 2017 resulting in being non-compliant with NASDAQ listing rules.

Ordinarily, conditions or events that raise substantial doubt about an entity's ability to continue as a going concern relate to the entity's ability to meet its obligations as they become due.

The Company evaluated its ability to meet its obligations as they become due within one year from the date that the financial statements are issued by considering the following:

- The Company raised $4.0 million of debt financing during the year ended December 31, 2016.
- The Company has been able to raise capital from short-term loans from insiders.
- As a result of the Company's restructurings that were implemented during the three months ended December 31, 2016, and again during the six months ended June 30, 2017, the Company's cost structure is now in line with its future revenue projections. See Footnote 5 for additional details regarding restructurings.

Management believes that the Company will generate enough cash from operations to satisfy its obligations for the next twelve months.

The Company will take the following actions, if it starts to trend unfavorable to its internal profitability and cash flow projections, in order to mitigate conditions or events that would raise substantial doubt about its ability to continue as a going concern:

- Raise additional capital through short-term loans.
- Implement additional restructuring and cost reductions.
- Raise additional capital through a private placement.
- Secure a commercial bank line of credit.

- Dispose of one or more product lines.
- Sell or license intellectual property.

NASDAQ Notice for Failure to Satisfy Continued Listing Rules

Our common stock is currently listed on the NASDAQ Capital Market. In order to maintain that listing, we must satisfy minimum financial and other requirements. On May 8, 2017, we received a written notification from The Nasdaq Stock Market LLC notifying us that we failed to comply with Nasdaq's Marketplace Rule 5550(b)(1) (the "Rule") because the Company's stockholders' equity as of March 31, 2017 fell below the required minimum of $2,500,000 and as of May 8, 2017 the Company does not meet the alternatives of market value of listed securities or net income from continuing operations for continued listing.

Under the Rules, the Company submitted a plan to regain compliance and received an extension from Nasdaq. The compliance plan includes several milestones to be completed throughout the fiscal year in order to regain full compliance. Although the Company will actively work to regain compliance, there is no assurance that the Company's common stock will not be delisted from Nasdaq.

On February 7, 2017, the Company entered into a short-term secured borrowing arrangement with William W. and Dieva L. Smith ("Smith") and on February 8, 2017 entered into a short-term secured borrowing arrangement with Steven L. and Monique P. Elfman ("Elfman") pursuant to which Smith and Elfman each loaned to the Company $1,000,000 and the Company issued to each of them a Secured Promissory Note (the "Original Notes") bearing interest at the rate of 18% per annum. The Original Notes were due on March 24, 2017 and are secured by the Company's accounts receivable and certain other assets. William W. Smith, Jr. is the Company's Chairman of the Board, President and Chief Executive Officer. Steven L. Elfman is a director of the Company.

On March 25, 2017, the Company entered into Amendment to the Original Note issued to Smith that extended the Maturity Date of the Note to June 26, 2017.

On March 31, 2017, the Company entered into a new short-term secured borrowing arrangement with Elfman for $1,000,000 which matured on June 23, 2017.

On June 30, 2017, the Company entered into a new short-term secured borrowing arrangement with each of Smith and Elfman, to refinance the prior Notes with each of them which matured on June 26, 2017 and June 23, 2017, respectively. Under the new borrowing arrangement, the Company issued to each of Smith and Elfman a new Secured Promissory Note ("Amended Notes") with a principal balance of $1,000,000, bearing interest at the rate of 12% per annum, and maturing on September 25, 2017. The maturity date of the Amended Note entered into with Smith may be extended by up to 180 days upon the mutual consent of the Company and Smith. Each of the Amended Notes are secured by the Company's accounts receivable and certain other assets.

At June 30, 2017, we had $2.4 million in cash and cash equivalents and $0.8 million of working capital.

Operating activities

Net cash used in operating activities was $3.8 million for the six months ended June 30, 2017. The primary uses of operating cash were to fund our net loss of $4.8 million, adding back non-cash net expenses of $1.6 million, and increases in accounts payable and accrued expenses of $1.3 million. This usage was offset by decreases in deferred revenue of $0.5 million and accounts receivable of $0.2 million.

Net cash used in operating activities was $3.7 million for the six months ended June 30, 2016. We received $2.8 million from accounts receivable, and there were non-cash expenses including stock-based compensation of $0.8 million and depreciation and amortization of $0.8 million. This was partially offset by our net loss of $7.0 million and increases of non-cash income of $0.6 million related to our Pennsylvania grant, and increases of other working capital of $0.5 million.

Investing activities

Net cash used in investing activities was $63,000 for the six months ended June 30, 2017 for capital expenditures.

Net cash used in investing activities was $1.3 million for the six months ended June 30, 2016 used to acquire Birdstep for $1.9 million net cash, and capital expenditures of $0.2 million offset by sale of sale of short-term investments of $3.4 million.

Financing activities

Net cash received from financing activities was $4.0 million for the six months ended June 30, 2017. We received $2.0 million from the sale of our common stock in a private placement and $2.0 million from short-term loans from insiders.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Contractual obligations and commercial commitments

The following table summarizes our contractual obligations and other commitments as of June 30, 2017 (in thousands):

	Payments due by period				
Contractual obligations:	Total	1 year or less	1-3 years	3-5 years	More than 5 years
Operating lease obligations	$9,104	$2,392	$4,003	$2,709	$ —
Notes payable	6,000	2,000	4,000	—	—
Purchase obligations	382	382	—	—	—
Pennsylvania state grant note	309	69	206	34	—
Total	$15,795	$4,843	$8,209	$2,743	$ —

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.

Recent Accounting Guidance

In May 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. The amendments in this ASU provide guidance about which changes to the terms or conditions of share-based payment award require an entity to apply modification accounting in Topic 718. Specifically, an entity should account for the effects of a modification unless all the following are met: (1) The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification; (2) The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (3)The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. This ASU is effective for those fiscal years, beginning after December 15, 2017. Early adoption is permitted and should be adopted on a prospective basis. The Company does not expect the adoption of this ASU to have a material impact on our financial statements and related disclosures.

In February 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and other (Topic 350): Simplifying the Test for Goodwill Impairment. Currently, Topic 350 requires an entity to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the entity performs Step 2 and compares the implied fair value of goodwill with the carrying amount of that goodwill for that reporting unit. An impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds the implied fair value of that goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit. To address concerns over the cost and complexity of the two-step goodwill impairment test, the amendments in this Update remove the second step of the test. An entity will apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. A public business entity SEC filer should adopt the amendments in this Update for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. The Company will be evaluating the impact of this guidance on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, to reduce the existing diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. Amendments in this update are effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The Company will be evaluating the impact of this guidance on our consolidated financial statements.

In March 2016, the FASB issued final guidance in ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which will change certain aspects of accounting for share-based payments to employees. The new guidance will require all income tax effects of awards to be recognized in the income statement when the awards vest or are settled. It will also allow an employer to repurchase more of an employee’s shares than it currently can for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. The guidance is effective for financial statements issued for annual periods beginning after December 15, 2016. Early adoption is permitted for all companies in any interim or annual period and must be adopted on a modified prospective approach. Due to the Company applying a full valuation allowance against its deferred tax assets, the nature of the change on the consolidated financial statements is not material.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. The Company will be evaluating the impact of this guidance on our consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments-Overall (Topic 825-10). The Amendments to this Update require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this Update also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the amendments in this Update requires disclosure of the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early application by public business entities to financial statements of fiscal years or interim periods that have not yet been issued or, by all other entities, that have not yet been made available for issuance of the following amendments in this Update are permitted as of the beginning of the fiscal year of adoption - an entity should present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The Company will be 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. In July 2015, the FASB deferred the effective date for annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods). Early adoption is permitted to the original effective date of December 15, 2016 (including interim reporting periods within those periods). The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company will be evaluating the impact of this guidance on our consolidated financial statements.

Critical Accounting Policies and Estimates

Our discussion and analysis of results of operations, financial condition, and liquidity are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America.

The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may materially differ from these estimates under different assumptions or conditions. On an on-going basis, we review our estimates to ensure that they 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 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.

On occasion, we enter into fixed fee arrangements, i.e. for trials, in which customer payments are tied to the achievement of specific milestones. Revenue for these contracts is recognized based on customer acceptance of certain milestones as they are achieved. We also enter hosting arrangements that sometimes include up-front, non-refundable set-up fees. Revenue is recognized for these fees over the term of the agreement.

For 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 June 30, 2017.

Goodwill

In accordance with FASB ASC Topic No. 350, Intangibles-Goodwill and Other, we review the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. The Company's annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the fair value of the Company's reporting units to the carrying value of the underlying net assets in the reporting units. If the fair value of a reporting unit is determined to be less than the carrying value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the fair value of the reporting unit and the fair value of its other assets and liabilities.

Intangible Assets and Amortization

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

Derivative Liabilities

The Company analyzes all financial instruments with features of both liabilities and equity under FASB ASC Topic No. 480, Distinguishing Liabilities From Equity and FASB ASC Topic No. 815, Derivatives and Hedging. Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in results of operations as adjustments to fair value of derivatives. The effects of interactions between embedded derivatives are calculated and accounted for in arriving at the overall fair value of the financial instruments. In addition, the fair values of freestanding derivative instruments such as warrant derivatives are valued using the Black-Scholes model.

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 income tax expense.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our financial instruments include cash and cash equivalents. At June 30, 2017, 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 both the three and six months ended June 30, 2017 and 2016, our revenues denominated in foreign currencies were de minimis. 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 June 30, 2017. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have determined that as of June 30, 2017, our disclosure controls and procedures were effective to ensure that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Management’s responsibility for financial statements

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

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

Changes in internal control over financial reporting

There have been no changes in our internal controls over financial reporting during the quarter ended June 30, 2017 that have materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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 in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. There have been no material changes to the risk factors described under Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, which was filed with the SEC on March 10, 2017.

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

On May 16, 2017, the Company entered into subscription agreements with four investors, one of whom is a director of the Company, pursuant to which the Company issued and sold an aggregate of 85,000 shares of its common stock at a price per share of $1.10 in a private placement. The transaction closed on May 17, 2017 and the Company realized gross proceeds of $93,500. 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.

The table set forth below shows all repurchases of securities by us during the three months ended June 30, 2017:

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
April 1 - 30, 2017	401	(a)	$ 0.86	—	—
May 1 - 31, 2017	—		—	—	—
June 1 - 30, 2017	40,678	(a)	$ 1.40	—	—
Total	41,079		$ 1.27		

The above table includes:

(a) Repurchases of stock by the Company as payment of withholding taxes in connection with the vesting of restricted stock awards, in an aggregate amount of 54,401 shares during the periods set forth in the table.

Item 6. Exhibits

Exhibit	Description
4.1	Form of Placement Agent Warrant, dated May 17, 2017 (filed as Exhibit 4.1 to the Company's Current Report on Form 8-K filed on May 17, 2017, and incorporated herein by reference).
10.1	Secured Promissory Note, dated March 31, 2017, issued by the Company to Steven L. Elfman and Monique P. Elfman (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 3, 2017, and incorporated herein by reference).
10.2	Form of Subscription Agreement, dated May 16, 2017 (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 17, 2017, and incorporated herein by reference).
10.3	Offer Letter by and between the Registrant and Timothy C. Huffmyer, dated June 19, 2017 (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 20, 2017, and incorporated herein by reference).
10.4	Secured Promissory Note, dated June 30, 2017, issued by the Company to William W. Smith, Jr. and Dieva L. Smith (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed on July 7, 2017, and incorporated herein by reference).
10.5	Secured Promissory Note, dated June 30, 2017, issued by the Company to Steven L. Elfman and Monique P. Elfman (filed as Exhibit 10.2 to the Company's Current Report on Form 8-K filed on July 7, 2017, and incorporated herein by reference).
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

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.
August 14, 2017	By /s/ William W. Smith, Jr. William W. Smith, Jr. Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
August 14, 2017	By /s/ Timothy C. Huffmyer Timothy C. Huffmyer Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)