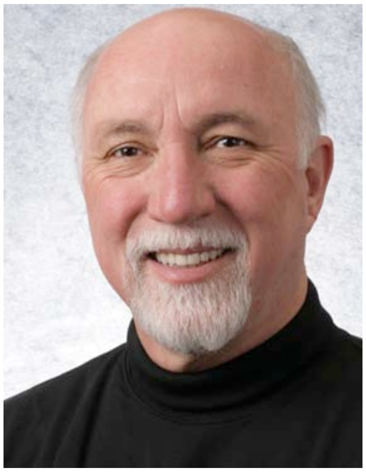

Dear Shareholder:

Inside, you will find the 2005 Annual Report for Smith Micro Software, Inc. (Nasdaq:SMSI). The fiscal year 2005 was truly a significant year for the evolution of our company. We began the year with very high expectations after the strong turnaround we saw during 2004, when we delivered increasing revenue and earnings growth. We started fiscal 2005 with some significant internal goals to achieve during the year. I am pleased to say we not only achieved them but also exceeded them. We especially looked to strengthen our balance sheet and broaden our products both organically and through acquisitions, with the goal of diversifying our business both from a product and customer concentration point of view. We continued on the growth path of aggressively working with our carrier customers who are deploying their wireless high-speed, broadband data services. We achieved these milestones while maintaining both strong revenue growth, as well as earnings growth during the year.

During Fiscal 2005, we saw record results, where annual revenue increased 53% to $20.3 million, which compared to the $13.3 million reported in 2004. Pro forma net income (net income factoring out amortization of intangible assets assumed by the Allume transaction) increased 60% to a record $5.5 million, or $0.24 on 22.8 million shares; this compared to $3.5 million or $0.19 per share on 18.5 million shares. We also finished the year with a record backlog of $4 million heading into 2006.

With regard to strengthening our balance sheet, in February of 2005 we completed a $22.4 million private placement of common stock through the investment bank, C.E. Unterberg Towbin, LLC. This significantly strengthened our balance sheet, brought in new institutional investors and made it possible for us to pursue acquisition candidates. In July 2005, we announced the acquisition of Allume Systems, Inc., a wholly owned subsidiary of International Microcomputer Software, Inc. (IMSI).Allume is a leading provider of compression software solutions that enable state of the art compression, security and archiving of data, including JPEG, with MPEG, and MP3 formats under development. The company's pioneering product suite, known as Stuffit® has been a de facto business compression standard since 1986. Its most recent development was a new JPEG compression technology that reduces the size of JPEG images up to 30% without any additional reduction of the actual image quality. This technology, known as StuffIt® Wireless, becomes very appealing to wireless carriers and for camera-enabled handset and PDA manufacturers since customers will be able to store many more still images on their devices, require less bandwidth to transfer photos over the wireless network and transfer the photos up to 30% faster due to the reduced file size. At this time, we are heavily involved in prototype testing in the lab and field and are very pleased with the progress.

Within our data connectivity solutions program, we continue to make significant progress. Verizon Wireless, our largest customer, has continued to rollout its wireless Broadband Access or EV-DO data service at a fast pace, adding hundreds of new cities as well as expanding its footprint throughout 2005. We obviously remain optimistic and excited about this, and believe they will continue rolling out their wireless broadband service to cover all of their service area.

During the year, we added some new high-speed connectivity customers. In February, we added ALLTEL, which chose our QuickLink Mobile data connectivity solution to support its high-speed data customers. ALLTEL has continued to expand its developing Axcess Broadband network, and we are pleased to be working closely with them in this build-out. In September, we signed on with Vodafone, which has the world's largest mobile community, to develop a CDMA based wireless data connectivity application for customers traveling to North America.

During 2005, we made strides with our new QuickLink Mobile Enterprise solution rollout. We signed on our first customer, a large US insurance Company based in the southwest, and we have developed a pipeline of strong prospects. We still maintain that this solution becomes much more relevant during 2006 and 2007.

Throughout 2005, we added some significant depth to our management team. In June we brought on Andy Schmidt as our new Chief Financial Officer, who brings a wealth of public company experience to the team.

We also strengthened our Board of Directors by adding Ted L. Hoffman to help direct the company's business initiatives as well as provide independent oversight of Smith Micro's wireless data business. Mr. Hoffman recently retired as Vice President, technology development of Verizon Wireless, where he was responsible for all network products and service development. He was responsible for managing the company's transition from analog to digital Code Multiple Access (CDMA) Infrastructure. We are very excited to have Ted with us as he brings a wealth of wireless market understanding and experience.

Overall, 2005 was a very busy and exciting time for Smith Micro Software. We added several new technologies both through acquisitions as well as through internal R&D. We added new customers, and most importantly, continued to show both record revenue and earnings growth. As we look ahead to 2006, we expect to continue to achieve strong results and we believe we have positioned the company extremely well to drive future growth. I invite you to examine the attached Annual Report (Form 10-K) for a detailed analysis of our performance in 2005, and I look forward to delivering a very successful 2006. I also invite you to examine our products on our web site at http://www.smithmicro.com.

Thank you for your continued support.

William W. Smith, Jr.
Chairman of the Board,
President and Chief Executive Officer

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2005

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission File Number 0-26536

SMITH MICRO SOFTWARE, INC.
(Exact name of registrant as specified in its charter)

Delaware	**33-0029027**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
51 Columbia, Suite 200, Aliso Viejo, CA	**92656**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(949) 362-5800**

Common Stock, $.001 par value	**Nasdaq SmallCap Market**
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act: Common Stock, $.001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES [X] NO [ ]

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 YES [X] NO [ ]

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 [X] NO [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K [ ].

Indicate by check mark if whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X]

As of June 30, 2005, the last business day of the registrant’s most recently completed second quarter, the aggregate market value of the common stock of the registrant held by non-affiliates was $63,670,654 based upon the closing sale price of such stock as reported on the Nasdaq SmallCap Market on that date. For purposes of such calculation, only executive officers, board members, and beneficial owners of more than 10% of the registrant’s outstanding common stock are deemed to be affiliates.

As of March 9, 2006, there were 22,434,369 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s Proxy Statement for the Annual Meeting of Stockholders to be filed with the Securities Exchange Act of 1934, are incorporated by reference in Part III of this report.

SMITH MICRO SOFTWARE, INC.

2005 FORM 10-K ANNUAL REPORT

TABLE OF CONTENTS

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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

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

- *our ability to predict consumer needs, introduce new products, gain broad market acceptance for such products and ramp up manufacturing in a timely manner;*
- *the intensity of the competition and our ability to successfully compete;*
- *the pace at which the market for new products develop;*
- *the response of competitors, many of whom are bigger and better financed than us;*
- *our ability to successfully execute our business plan and control costs and expenses;*
- *our ability to protect our intellectual property and our ability to not infringe on the rights of others;*
- *our depressed market capitalization; and*
- *those additional factors which are listed under the section "Risk Factors" on page 21 of this report.*

All forward looking statements included in this document are based on information available to us on the date hereof. We do not undertake any obligation to revise or update publicly any forward-looking statements for any reason.

PART I

Item 1. BUSINESS

General

Smith Micro Software, Inc. is a diversified developer and marketer of wireless communication software products and services. Our primary focus and strategy for our products and services is directed to wireless communications including wireless wide area network (WWAN) software, handset phonebook management, managing the download of music to a handset, and Wi-Fi software. We sell our products and services to some of the world's leading companies as well as to consumers. Specific Smith Micro wireless products include QuickLink Mobile, QuickLink Mobile Enterprise and QuickLink Mobile Phonebook. The proliferation of wireless technologies is providing new opportunities globally. The wireless infrastructures being implemented, such as 1xRTT, GPRS and the newer 3G technology including EVDO UMTS and HSDPA, offer wider bandwidth wireless data services. This infrastructure combined with mobile platforms such as the basic mobile phone, notebook computing devices ("PCs") and personal communications devices ("PDAs") provide opportunities for new communications software products. Our core communications technology is designed to address this emerging wireless data market.

We manufacture, market and sell value-added wireless connectivity products targeted to the original equipment manufacturers ("OEM") market, particularly wireless service providers and mobile phone manufacturers, as well as direct to the consumer. We offer software products for Windows, Mac OSX, Unix and Linux operating systems. The underlying design concept is the long-standing Smith Micro purpose to "enhance the out-of-box experience" for the customer. Our custom engineering services bring more than 20 years of hardware and software experience, having shipped over 60 million copies of products to OEM's seeking to better market their products by adding product features, customizing existing features and translating applications into additional languages.

QuickLink Mobile provides notebook users with the ability to easily roam between wireless wide area networks ("WWAN") and Wi-Fi hot spots. QuickLink Mobile allows users to seek out and select available hot spots in their area. We currently maintain OEM relationships with many wireless carrier companies, including Verizon Wireless, Vodafone, Telus, Alltel, UTStarcom, LG Electronics and Kyocera. Sales to Verizon Wireless amounted to approximately 57.1% and 68.4% of the Company's net revenues for 2005 and 2004, respectively. Sales to Verizon Wireless, Cingular Wireless and Apple Computer amounted to approximately 27.0%, 10.7% and 10.2% of our net revenues for 2003, respectively.

During the fourth quarter of 2004, we announced our latest addition to the QuickLink family, namely QuickLink Mobile Enterprise, aimed at the enterprise marketplace to take advantage of the demand for additional security built into our wireless application. This product was introduced in the second quarter of 2005. In addition to addressing the latest technologies and concerns for security in the wireless space, QuickLink Mobile Enterprise is a combination wireless wide area network (WWAN) and Wi-Fi client application that provides the same easy to use interface and functionality regardless of carrier or device. The application supports over 180 carriers worldwide, hundreds of wireless devices and PDA's, many different PC Cards, and several integrated WWAN devices in notebooks.

In the fourth quarter of 2005, we launched a new music product, the Music Essentials Kit for Verizon Wireless. The Music Essentials kit allows users to download music from Verizon Wireless, or transfer music files from a PC to a handset. This product first shipped in our fourth quarter of 2005 and is expected to be a significant contributor to 2006 revenues.

A future initiative for our OEM group is launching StuffIt Wireless. StuffIt Wireless incorporates our patent-pending JPEG compression technology that provides a superior compression of multi-media data. This technology allows device manufacturers and wireless carriers to increase storage space on devices, increase the quality of images and optimize wireless bandwidth. We are currently in the prototype stage of product development with potential customers and plan to fully market this product in 2007.

Our Enterprise Solutions Group delivers wireless mobility solutions into medium and large enterprise businesses. In addition to offering products designed to enhance security, lower help desk costs and deliver a more fluid wireless experience, the Enterprise Solutions Group provides architectural design and implementation services that guarantee to our customers that the applied solution is the best possible combination for the target environment. Combined with our wireless mobility business direction are our eBusiness applications and services initiative. This area of business leverages our many years of providing web-based applications custom-tooled to meet the needs of the growing business. From basic web design to complex solutions involving complete customer management, online commerce and fulfillment services, the Enterprise Solutions Group helps businesses refine their processes and implement cost-effective, empowering systems.

The Consumer Products Group offers products in the PC Utility, Fax and eBusiness markets. Smith Micro's complete line of consumer products is available through direct sales on its websites, partner websites or its order desk and through traditional retail outlets. The Consumer group is focused on the following market segments: Compression, Access and Transmission (CAT), Utilities including Diagnosis, Performance, Security and Internet and Compilation and Lifestyle.

As a world leader and innovator in data and image compression field our StuffIt product line helps users compress, encrypt and archive information. In January 2005 the company introduced its revolutionary patent pending JPEG compression technology. This breakthrough technology can compress JPEG photos and images up 30% without and additional loss in image quality. Combining our new image compression with StuffIt's traditional file compression accelerates the transmission of files over the Internet. Plus, with built-in error protection and encryption (up to 512- bit encryption), users can send StuffIt archives with peace of mind.

We currently operate in two business segments: Products and services. We do not separately allocate operating expenses to these segments, nor do we allocate specific assets to these segments. Therefore, segment information reported includes only revenues and cost of revenues. See Note 8 of Notes to Consolidated Financial Statements for financial information related to our operating segments.

Research and development expenses amounted to $4.0 million, $2.6 million and $2.5 million for the years ended December 31, 2005, 2004 and 2003, respectively. Our research and development expenses consist primarily of personnel and equipment costs required to conduct our software development efforts. We remain focused on the development and expansion of our technology, particularly our wireless, diagnostic, utility and Internet software technologies.

We were incorporated in California in November 1983, and we reincorporated in Delaware in June 1995. Our principal executive offices are located at 51 Columbia, Suite 200, Aliso Viejo, California 92656. Our telephone number is (949) 362-5800. Our website address is www.smithmicro.com. We make our filings with the SEC available on the Investor Relations page of our website. Information contained on our website is not part of this Annual Report on Form 10-K.

Industry Backgrounds

Wireless Industry - The evolving types of 3G wireless data infrastructures being implemented, such as EV-DO, HSDPA, and UMTS wireless platforms have expanded to include the basic mobile phone, personal computing devices (PC's) and personal communications devices including PDA's and various handheld devices. The adoption of these new mobile and wireless communications services provides opportunities for new communications software products. In addition, these devices are becoming multimedia devices, which include digital cameras, portable music players and full motion video cameras.

Compression, Access and Transmission – Computer compression helps users solve fundamental issues that they all share: Sending information in a way that is fast, safe and secure, accessing and archiving information and the maximization of storage capacity and Internet bandwidth.

Diagnostic/Utility Software Industry - Diagnostic and utility software products assist home and corporate users, and hardware manufacturers and service companies to identify and repair computer system related errors and problems. The company focuses on utilities covering two market segments: Diagnosis and performance, and security and internet. These products are designed to enhance, protect, clean, diagnose and help customers maximize their computer's performance and keep them secure from spam, spyware and computer hackers.

Computer Consulting Industry - A corporation's information technology department generally evaluates whether to design, build or support computer applications internally or to contract some or all of this work to outside specialists with technical expertise. Many corporations choose to use outside consulting contractors for this work in order to focus their resources on their core competencies and avoid the time and expense required to train their own employees. Our efforts are focused on these outsourced services.

Products and Services

The following is a list of the software products and services we offer, as well as a brief description of their principal features and functions:

Software Products	
OEM & Wireless	
QuickLink® Mobile	(Windows and Mac) Turns data capable wireless handsets, PDA's and wireless integrated notebook PC's into wireless data connectivity devices.
QuickLink® Phone Manager	(Windows) Enables users to be able to easily edit the phonebook and calendar that reside on a wireless handset on a PC computer. This product enables you to transfer PIM and calendar data from your computer to your handset and to move similar data from your handset back to the PIM on the computer.
QuickLink® Mobile Enterprise	(Windows) Expands QuickLink Mobile by offering additional features that are tailored specifically for the enterprise customer such as customizations and 802.1x Wi-Fi security.
Fax & Communication	
FAXstf™ X & FAXstf™ X Pro	Enables users to exchange faxes and data files with remote modems, fax/modems, and fax machines quickly and easily on the Mac OS X operating environment.
HotFax® MessageCenter	An integrated voice, fax and data communication software program that lets users receive voice mail and exchange faxes and data files with remote modems, fax/modems, and fax machines quickly and easily.
Compression, Access and Transmission	
StuffIt® Wireless	A breakthrough image compression technology that reduces the size of a JPEG picture file up to 30% without any additional loss in image quality. This technology allows device manufacturers and wireless carriers to increase storage space on devices, increase the quality of images and optimize wireless bandwidth.
StuffIt® Image	An evolving set of technologies to handle image compression for multiple image formats. Target markets include digital camera manufacturers, Enterprise Content Management and medical imaging.
StuffIt® Deluxe	(Windows and Mac) - A complete compression, expansion, and access solution. Providing easy to use award winning archiving and security from 512 bit encryption, to Adobe and Microsoft Office plug-ins to our JPEG image compression.
StuffIt® Standard Edition	(Windows and Mac) - Our basic core product that provides basic compression and decompression functionality.
StuffIt® Expander	(Windows and Mac) - A universal expansion product that decompresses and

	decodes all major compression formats. Expander is distributed free of charge and encourages the wide distribution of files in StuffIt format and enhancess the market for our commercial products.
Utilities	
CheckIt® Diagnosis	(Windows) - Provides end-users the hardware information they need to evaluate, fine-tune and manage their system.
CheckIt® System Performance Suite	(Mac) Provides customers with repair, cleaning and diagnosis utilities for their Macintosh.
Spring Cleaning®	(Windows and Mac) - Our uninstaller and cleanup product that removes the clutter that accumulates on your computer from unwanted and unused files. Spring Cleaning cleans and improves the performance of your computer.
Internet Cleanup	(Windows and Mac) - An Internet cleanup and privacy product, which allows a user to remove specific unwanted files gathered by a Web browser every time you surf the Internet. It increases computer security by blocking pop-ups and removing spyware.
BoostXP	(Windows) - A complete collection of all of the necessary tools to keep your system running smooth, faster and error-free. Accelerate, clean, customize and protect your PC.
Lifestyle	
Aquazone®	(Windows and Mac) - A virtual aquarium for your computer. Offering multiple collections which includes sharks, jellyfish, turtles, and 40 fish species to our expansion pack of goldfish, jellyfish and deep sea divers.
Personal Photo	(Windows) - Manage and share photos. You can create custom photo albums, edit your pictures, print and create photo calendars and postcards.

Services	
Consulting	Consulting services range from complete website design and installation consulting services.
Hosting	We maintain a network operations facility that is monitored 24 x 7 to ensure maximum uptime. We offer a broad spectrum of bandwidth and service options to customers. We host customers on our servers or house their server at our location.
Fulfillment	An extension of our eBusiness activity includes order fulfillment services for customer web stores.

Sales and Marketing

Our products are available worldwide to customers through original equipment manufacturers. We also sell products and product upgrades over the Internet through our own web store at www.smithmicro.com.

Our OEM market continues to evolve as we continue to offer new communications products and OEM's adopt new technologies and software bundling techniques. Our OEM customers include wireless service providers, wireless phone manufacturers and other PC related equipment manufacturers. These manufacturers bundle our software products with their own products. We have translated selected products into as many as eighteen languages to allow our OEM customers the flexibility of offering multi-language products that meet the needs of their worldwide markets.

Our three largest OEM customers (Verizon Wireless, Kyocera Wireless and Alltel in 2005), and their respective affiliates, in each year, have accounted for 63.5 % of our net revenue in 2005, 77.8% of our net revenue in 2004 and 47.9% of our net revenues in 2003. Our major customers could reduce their orders of our products in favor of a competitor's product or for any other reason. The loss of any of our major OEM customers or decisions by a significant OEM customer to substantially reduce purchases could have a material adverse effect on our business.

We have historically operated with little backlog because we have generally shipped our software products and recognized revenue shortly after we received orders because our production cycle has traditionally been very short. As a result, our sales in any quarter were generally dependent on orders that were booked and shipped in that quarter. As our wireless business has evolved, production cycle time for items such as data kits has increased to the point that orders received towards the end of a quarter may not ship until the subsequent quarter. Additionally, customers may issue purchase orders that have extended delivery dates. These situations make it difficult for us to predict what our revenues and operating results will be in any quarter. Therefore, the level of backlog is not necessarily indicative of trends in our business. As of December 31, 2005, we had a backlog of approximately $4.0 million, as compared to $1.0 million at December 31, 2004.

Customer Service and Technical Support

We provide technical support and customer service through our web site, email, telephone and fax. OEM customers generally provide their own primary customer support functions and rely on us for back-up support for their own technical support personnel.

Product Development

The software industry, particularly the wireless market, is characterized by rapid and frequent changes in technology and user needs. We work closely with industry groups and customers, both current and potential, to help us anticipate changes in technology and determine future customer needs. Software functionality depends upon the capabilities of the hardware. Accordingly, we maintain engineering relationships with various hardware manufacturers and we develop our software in tandem with their development. Our engineering relationships with manufacturers, as well as with our major customers, are central to our product development efforts. We remain focused on the development and expansion of our technology, particularly in the wireless space. Research and development expenditures amounted to $4.0 million, $2.6 million and $2.5 million for the years ended December 2005, 2004 and 2003, respectively.

Manufacturing

Our software is sold in several forms. We offer a package or kit that may include: CD-ROM(s) for product and hardware-specific drivers; a cable; a manual; and certain other documentation or marketing material. We offer software on CD-ROMs. We also permit selected OEM customers to duplicate our products on their own CD-ROM's and pay a royalty based on usage. The majority of our OEM business requires that we provide a CD, which includes a soft copy of a user guide. In other cases, we provide a complete data connectivity kit that includes a CD, manual and cable. Finally, we grant licenses to certain OEM customers that enable those customers to preload a copy of our software onto a personal computer. With the enterprise sales program, we offer site licenses under which a corporate user is allowed to distribute copies of the software to users within the corporate sites.

Our product development group produces a product master for each product that is then duplicated and packaged into products by the manufacturing organization. All product components are purchased by our personnel in our Aliso Viejo, California facility. The manufacturing is subcontracted to outside vendors include the replication of CD-ROM's and the printing of documentation materials. Assembly of the final package is completed by an outside vendor or in our Aliso Viejo, California facility.

Competition

The markets in which we operate are highly competitive and subject to rapid changes in technology. Rapidly changing technology combined with relatively low barriers to entry in the communication software market is constantly creating new opportunities, and we expect new competitors to enter the market. We also believe that competition from established and emerging software companies will continue to intensify as the emerging mobile, wireless and Internet markets evolve. We compete with other software vendors for the attention of customers as well as in our efforts to acquire technology and qualified personnel.

We believe that the principal competitive factors affecting the communication software market include: product features, ease of use, customization to customer-specific needs, product quality, price, customer service and effective sales and marketing efforts. Although we believe that our products currently compete favorably with respect to these factors, there can be no assurance that we can maintain our competitive position against current and potential competitors. We believe that the market for our software products has been and will continue to be characterized by significant price competition. A material reduction in the price of our products could negatively affect our profitability. We face competition from Microsoft due to its market dominance and the fact that it is the publisher of the most prevalent personal computer operating system, Windows. Microsoft represents a significant competitive threat to all personal computer software vendors, including us.

Many existing and potential OEM customers have technological capabilities to develop products that compete directly with our products. In such event, these customers may discontinue purchases of our products. Our future performance is substantially dependent upon the extent to which existing OEM customers elect to purchase communication software from us rather than design and develop their own software. Because our customers are not contractually obligated to purchase any of our products, they may cease to rely, or fail to expand their reliance on us as a source for communication software in the future.

Proprietary Rights and Licenses

Our success and ability to compete is dependent upon our software code base, our programming methodologies and other intellectual properties. To protect our proprietary technology, we rely on a combination of trade secrets, nondisclosure and patent, copyright and trademark law that may afford only limited protection. As of December 31, 2005, six currently effective U.S. patents have been issued since December 1997 and five patent applications are currently pending. These patents provide generalized protection to our intellectual property base, and we will continue to apply for various patents and trademarks in the future.

We seek to avoid disclosure of our intellectual property by requiring employees and consultants with access to our proprietary information to execute confidentiality agreements with us and by restricting access to our source code. The steps that we have taken to protect our proprietary technology may not be adequate to deter misappropriation of our proprietary information or prevent the successful assertion of an adverse claim to software utilized by us. In addition, we may not be able to detect unauthorized use of our intellectual property rights or take effective steps to enforce those rights.

In selling our products, we primarily rely on "shrink wrap" licenses that are not signed by licensees and may be unenforceable under the laws of certain jurisdictions. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as do the laws of the United States. Accordingly, the means we use currently to protect our proprietary rights may not be adequate. Moreover, our competitors may independently develop technology similar to ours. We also license technology on a non-exclusive basis from several companies for inclusion in our products and anticipate that we will continue to do so in the future. If we are unable to continue to license these technologies or to license other necessary technologies for inclusion in our products, or if we experience substantial increases in royalty payments under these third party licenses, our business could be materially and adversely affected.

Employees

As of December 31, 2005, we had a total of ninety-one employees: forty-eight engaged in engineering; twenty-three in sales and marketing; twelve in management and administration; five in manufacturing and three in customer support. We utilize temporary labor to assist during peak periods of manufacturing volume. We believe that our future success will depend in large part upon our continuing ability to attract and retain highly skilled managerial, sales, marketing, customer support, research and development personnel and consulting staff. Like other software companies, we face intense competition for such personnel, and we have at times experienced and continue to experience difficulty in recruiting qualified personnel. There can be no assurance that we will be successful in attracting, assimilating and retaining other qualified personnel in the future. We are not subject to any collective bargaining agreement and we believe that our relationships with our employees are good.

Item 2. PROPERTIES

Our corporate headquarters, including our principal administrative, sales and marketing, customer support and research and development facility, is located in Aliso Viejo, California, where we currently lease and occupy approximately 23,500 square feet of space pursuant to a lease that expires May 31, 2009. We operate both our products and services reporting segments within this facility.

We also lease approximately 7,700 square feet in Watsonville, California under a lease that expires September 30, 2010. We are currently working on a new operating lease for our facility in Lee's Summit, Missouri to replace the lease that expired in June 2005. During 2003, we terminated leases in San Diego, California and Beaverton, Oregon.

We believe that suitable additional or alternative space will be available in the future on commercially reasonable terms as needed.

Item 3. LEGAL PROCEEDINGS

There are no pending material legal issues at this time although we may become subject to various legal proceedings and claims that arise in the ordinary course of business.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of stockholders during the quarter ended December 31, 2005.

PART II

Item 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

Our common stock is traded on the Nasdaq SmallCap Market under the symbol "SMSI." The high and low sale prices for our common stock as reported by Nasdaq are set forth below for the periods indicated.

	High	Low
YEAR ENDED DECEMBER 31, 2005:		
First Quarter	$ 9.63	4.65
Second Quarter	5.00	3.44
Third Quarter	7.39	4.02
Fourth Quarter	8.00	5.41
YEAR ENDED DECEMBER 31, 2004:		
First Quarter	3.66	2.00
Second Quarter	3.31	1.80
Third Quarter	5.50	1.28
Fourth Quarter	11.20	3.27

On March 9, 2006, the closing sale price for our common stock as reported by Nasdaq was $8.99.

Holders

As of March 9, 2006, there were approximately 144 holders of record of our common stock based on information provided by our transfer agent.

Dividends

We have never paid any cash dividends on our common stock and we have no current plans to do so.

Recent Sales of Unregistered Securities

Not applicable.

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes thereto appearing elsewhere in this Annual Report. The following selected consolidated statement of operations data for the years ended December 31, 2005, 2004 and 2003, and the consolidated balance sheet data at December 31, 2005 and 2004, have been derived from audited consolidated financial statements included elsewhere in this Annual Report. The consolidated statement of operations data presented below for the years ended December 31, 2002 and 2001, and the consolidated balance sheet data at December 31, 2003, 2002 and 2001 are derived from audited consolidated financial statements that are not included in this Annual Report.

	Year Ended December 31,				
	2005	2004	2003	2002	2001
Consolidated Statement of Operations Data:					
Net Revenues:					
Products	$ 19,637	$ 12,394	$ 6,291	$ 6,029	$ 6,945
Services	621	922	925	1,102	2,544
Total Net Revenues	20,258	13,316	7,216	7,131	9,489
Cost of Revenues:					
Products	3,818	2,530	1,350	1,420	1,880
Services	285	380	321	782	2,048
Total Cost of Revenues	4,103	2,910	1,671	2,202	3,928
Gross profit	16,155	10,406	5,545	4,929	5,561
Operating expenses:					
Selling and marketing	3,410	1,519	1,666	2,175	4,571
Research and development	3,963	2,556	2,506	2,162	2,997
General and administrative	4,621	2,868	2,330	2,387	3,847
Restructuring Costs	-	-	-	-	380
Total operating expenses	11,994	6,943	6,502	6,724	11,795
Operating income (loss)	4,161	3,463	(957)	(1,795)	(6,234)
Interest Income	667	53	37	45	199
Income (Loss) before income taxes	4,828	3,516	(920)	(1,750)	(6,035)
Income tax expense (benefit)	104	71	3	(1,062)	90
Net Income (Loss)	$ 4,724	$ 3,445	$ (923)	$ (688)	$ (6,125)
Net income (loss) per share, basic	$ 0.22	$ 0.20	$ (0.06)	$ (0.04)	$ (0.38)
Weighted average shares, basic	21,351	17,267	16,511	16,235	16,232
Net income (loss) per share, fully diluted	$ 0.21	$ 0.19	$ (0.06)	$ (0.04)	$ (0.38)
Weighted average shares, fully diluted	22,806	18,412	16,511	16,235	16,232

	As of December 31,				
	2005	2004	2003	2002	2001
Consolidated Balance Sheet Data:					
Total assets	$ 42,716	$ 12,828	$ 6,587	$ 6,766	$ 9,257
Total liabilities	3,759	1,729	997	1,154	2,955
Accumulated deficit	(11,945)	(16,669)	(20,114)	(19,191)	(18,503)
Total stockholders' equity	$ 38,957	$ 11,099	$ 5,590	$ 5,612	$ 6,302

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction and Overview

Our business model is based primarily upon the design, production and sale of wireless connectivity software for use with wireless communication networks worldwide. Our products are utilized in major wireless networks throughout the world that support data communications through the use of cell phones or other wireless communication devices such as PC cards. Wireless network providers generally incorporate our products into their accessory products sold directly to individual consumers to offer wireless PC data connectivity to their wireless networks.

Our business is primarily dependent upon the demand for wireless communications and the corresponding requirements for wireless connectivity software to support this demand. During the last three years, demand for these types of products has fluctuated dramatically, and there has been a significant increase in price competition within our industry.

We continue to invest in research and development of wireless software products, and we believe that we have one the industry’s leading wireless product lines in terms of performance and features. We believe that our “out-of-the-box” design technology further differentiates our products.

We also sell eBusiness and utility software and professional consulting services related to eBusiness applications.

During 2005, we have maintained a sharp focus on our operating cost structure while ensuring that we maintain our operating flexibility to support future growth in the industry. We measure success by monitoring our net sales and gross margins and operating cash flow. We believe that there continues to be excellent growth opportunities within the wireless communications software marketplace and we continue to focus on positioning Smith Micro to benefit from these opportunities.

Results of Operations

The following table sets forth certain consolidated statement of operating data as a percentage of total revenues for the periods indicated:

	Years Ended December 31,		
	2005	**2004**	**2003**
Net Revenues:			
Products	96.9%	93.1%	87.2%
Services	3.1%	6.9%	12.8%
Total net revenues	100.0%	100.0%	100.0%
Cost of revenues:			
Products	18.9%	19.0%	18.7%
Services	1.4%	2.9%	4.5%
Total cost of revenues	20.3%	21.9%	23.2%
Gross profit	79.7%	78.1%	76.8%
Operating expenses:			
Selling and marketing	16.8%	11.4%	23.1%
Research and development	19.6%	19.2%	34.7%
General and administrative	22.8%	21.5%	32.3%
Total operating expenses	59.2%	52.1%	90.1%
Operating Income (Loss)	20.5%	26.0%	-13.3%
Interest Income	3.3%	0.4%	0.5%
Income (Loss) before income taxes	23.8%	26.4%	-12.8%
Income tax expense (benefit)	0.5%	0.5%	0.0%
Net Income (Loss)	23.3%	25.9%	-12.8%

Revenues

Total net revenues were $20.3 million, $13.3 million and $7.2 million in 2005, 2004 and 2003, respectively, with an increase of $6.9 million, or 52.1% from 2004 to 2005 and an increase of $6.1 million, or 84.5% from 2003 to 2004. The increase in our revenues from 2003 through 2005 is attributed to the growth in sales of our wireless products and in 2005 also includes the acquisition of Allume. Sales to individual customers and their affiliates, which amounted to more than 10% of the Company's net revenues, included one OEM customer at 57.1% in 2005, one OEM customer at 68.4% of revenues in 2004 and three OEM customers at 27.0%, 10.7% and 10.2% of revenues in 2003.

We currently operate in two business segments: products and services. In addition, product revenues are broken down into three business units, Wireless and OEM, Retail and Distribution and Internet & Direct Sales. Our Retail and Distribution sales represent the sales of Allume products to distributors, retail customers and individuals. Allume was acquired on July 1, 2005 (See Note 2 of Notes to Consolidated Financial Statements). Internet & Direct Sales unit includes legacy Smith Micro utility and fax software products as well as consulting, fulfillment and hosting revenue.

The following table shows the net revenues and cost of revenues generated by each segment:

	Year Ended December 31,					
	2005		2004		2003	
	Products	Services	Products	Services	Products	Services
Wireless & OEM	$ 13,954	$ -	$ 11,424	$ -	$ 4,711	$ -
Retail & Distribution	4,886	-	-	-	-	-
Internet & Direct	797	621	970	922	1,580	925
Total Revenues	19,637	621	12,394	922	6,291	925
Cost of revenues	3,818	285	2,530	380	1,350	321
Gross Profit	$ 15,819	$ 336	$ 9,864	$ 542	$ 4,941	$ 604

Products. Net revenues from sales of products were $19.6 million, $12.4 million and $6.3 million for 2005, 2004 and 2003, respectively, representing an increase of $7.2 million, or 58.4% from 2004 to 2005 and an increase of $6.1 million, or 97.0% from 2003 to 2004. Product revenues accounted for 96.9% of total revenues in 2005, 93.1% of total revenues in 2004 and 87.2% of total revenues in 2003. There are two key drivers to the increase in our product revenues from 2004 to 2005. Our core wireless business increased from $11.4 million to $13.9 million. The increase can be attributed to the continued success of the wireless broadband data rollouts by our carrier customers. The second key contributor was the addition of the Retail and Distribution business unit this year (Allume acquisition on July 1, 2005), which posted revenues of $4.9 million for 2005. Internet and Direct sales continue to decrease reflecting a continued change in focus for the business. The change in our product revenue from 2003 to 2004 is primarily due to the increase in our core wireless business, for which sales to Verizon were $7.2 million consisting of sales of QuickLink Mobile and QuickLink Mobile Phonebook. Internet & Direct Sales decreased, both in absolute dollars and as a percentage of our total revenues, reflecting a repositioning of our business from the retail fax and utility software business to the wireless communications business.

We traditionally have relatively little backlog for our OEM products at any given time and we have not considered backlog to be a significant indicator of future performance. However, as our wireless business has evolved, production cycle time for items such as data kits has increased to the point that orders received towards the end of a quarter may not ship until the subsequent quarter. Additionally, customers may issue purchase orders that have extended delivery dates. Therefore, in 2004, we began tracking our quarterly backlog situation although the level of backlog is not necessarily indicative of trends in our business. As of December 31, 2005 however, we had a backlog of $4.0 million, comparing to $1.0 million at December 31, 2004 when we first began reporting backlog, resulting from orders placed late in the fourth quarter and not shipped. Since we generally do not produce software in advance of anticipated orders our revenues in any quarter are substantially dependent on orders booked in that quarter.

Services. Consulting services revenues were $621,000, $922,000 and $925,000 in 2005, 2004 and 2003, respectively, representing a decrease of $301,000, or 32.7% from 2004 to 2005 and a decrease of $3,000, or 0.3% from 2003 to 2004. Services revenue accounted for 3.1% of total revenues in 2005, 6.9% of total revenues in 2004 and 12.8% of total revenues in 2003. The decrease in service revenue is due to the reduced focus on consulting services, which was announced in the first quarter of 2002, due to the decrease in demand for such services.

Cost of Revenues and Gross Margin

Cost of Product Revenues. Cost of product revenues was $3.8 million, $2.5 million and $1.4 million in 2005, 2004 and 2003, respectively, representing an increase of $1.3 million, or 50.9%, from 2004 to 2005 and an increase of $1.1 million, or 87.4%, from 2003 to 2004. Gross margin as a percentage of net revenue was 79.7% for 2005 as compared to 78.1% for 2004 and 76.8% for 2003. Cost of Revenues for the current year includes $534,000 of amortization of intangibles associated with the acquisition of Allume which is not included in 2004 or 2003 expenses. Factoring out amortization of intangibles, gross margin for 2005 was 82.4%. The 4.3% pro-forma increase from the year earlier period is attributed to increased sales of higher margin PC card software product versus lower margin Mobile Office Kit products.

Direct costs of revenues consist primarily of CD replication costs. We use a variety of providers located in China, Korea and the United States. We consider CD replication to be a commodity with little or no risk to supplier fluctuations. We also purchase proprietary cables from Motorola and generic OEM cables from a variety of suppliers.

Cost of Service Revenues. Cost of service revenues was $285,000, $380,000 and $321,000 in 2005, 2004 and 2003, respectively, representing a decrease of $95,000, or 25.0% from 2004 to 2005 and an increase of $59,000, or 18.4% from 2003 to 2004. Cost of Service revenue as a percentage of Service revenues was 54.1% for 2005, 41.2% for 2004 and 34.7% in 2003. Cost of service revenues includes the cost of our consulting personnel and the cost of any outside consultants contracted to support our staff and vary by contract.

Operating Expenses

The following table presents a breakdown of our operating expenses by functional category and as a percentage of total net revenues:

	Years Ended December 31,								
	2005			2004			2003		
Operating expenses:									
Selling and marketing	$	3,410	16.8%	$	1,519	11.4%	$	1,666	23.1%
Research and development		3,963	19.6%		2,556	19.2%		2,506	34.7%
General and administrative		4,621	22.8%		2,868	21.5%		2,330	32.3%
Total operating expenses	$	11,994	59.2%	$	6,943	52.1%	$	6,502	90.1%

Selling and Marketing. Selling and marketing expenses were $3.4 million, $1.5 million and $1.7 million in 2005, 2004 and 2003, respectively, representing an increase of $1.9 million, or 124.5%, from 2004 to 2005 and a decrease of $147,000 or 8.8%, from 2003 to 2004. Our selling and marketing expenses consist primarily of personnel costs, advertising costs, sales commissions and trade show expenses. These expenses vary significantly from quarter to quarter based on the timing of trade shows and product introductions. While most of the increases in selling and marketing expenses in 2005 were due to the Allume acquisition, we also had a slight increase in headcount and increases in costs related to product collateral concept and design. The decrease in costs from 2003 to 2004 is directly attributable to the elimination of channel marketing expenses of approximately $100,000 and the elimination of depreciation and other miscellaneous expenses of $95,000 relating to the San Diego sales office which was closed in 2003. These decreases were offset by an increase in salaries and related expenses of approximately $50,000 which relates to the reallocation of resources from other departments to sales and marketing. Advertising expenses were $223,000, $47,000 and $95,000 for the years ended December 31, 2005, 2004 and 2003, respectively. Selling and marketing expenses were 16.8%, 11.4% and 23.1% of revenues in the years ended December 31, 2005, 2004 and 2003, respectively. Increases in selling and marketing expenses as a percentage of revenues in 2005 were caused by the increase in costs as described above.

Research and Development. Research and development expenses were $4.0 million, $2.6 million and $2.5 million in 2005, 2004 and 2003, respectively, representing increases of $1.4 million, or 55.0%, from 2004 to 2005 and $50,000, or 2.0%, from 2003 to 2004. Our research and development expenses consist primarily of personnel and equipment costs required to conduct our software development efforts. We remain focused on the development and expansion of our technology, particularly our wireless, multi-media, and compression software technologies. The increase in our research and development expenses in each year was primarily due to the development of new wireless products that were released during the periods, with an accompanying increase in headcount and a refocus of engineering resources from consulting projects to development. In 2005, the key driver to increased R&D expense was the acquisition of Allume Systems on July 1, 2005 and the associated engineering staff which is focused on new compression technology. Research and development expenses were 19.6%, 19.2% and 34.7% of revenues in the years ended December 31, 2005, 2004 and 2003, respectively. The decrease in research and development expenses as a percentage of revenues from 2003 to 2004 is due to the significant increase in revenues during the period.

General and Administrative. General and administrative expenses were $4.6 million, $2.9 million and $2.3 million in 2005, 2004 and 2003, respectively, representing increases of $1.8 million, or 61.1%, from 2004 to 2005 and $538,000, or 23.1%, from 2003 to 2004. The increase in General and Administrative costs from 2004 to 2005 was primarily due to the acquisition of Allume Systems on July 1, 2005 and the assumption of Allume G&A staff and certain integration costs. The increase in General and Administrative costs from 2003 to 2004 consists of increases in accounting, legal and consulting fees of approximately $120,000, travel expenses of approximately $65,000 and compensation and benefit costs of approximately $320,000. General and administrative expenses were 22.8%, 21.5% and 32.3% of revenues in the years ended December 31, 2005, 2004 and 2003, respectively. The decrease in general and administrative expenses as a percentage of revenues from 2003 to 2004 is due to the increase in revenues, partially offset by the absolute dollar increase in expenses. Beginning in fiscal 2006, we will be adopting FAS 123R, which requires the expensing of stock options. Taking into account options issued and outstanding at December 31, 2005, we estimate that our 2006 stock compensation expense would be approximately $2.6 million. New option issuances or restricted stock grants made in fiscal 2006 would increase the estimate.

Interest Income. Interest income was $667,000, $53,000 and $37,000 in 2005, 2004 and 2003, respectively, representing increases of $614,000, or 1,158.5% from 2004 to 2005 and $16,000, or 43.2% from 2003 to 2004. The differences in our interest income are directly related to the fluctuations in our cash balances during the periods and changing interest rates. We have not changed our investment strategy during the periods being reported, with our excess cash consistently being invested in short term marketable securities. (See “Liquidity and Capital Resources” for further discussion elsewhere in this report.)

Provision for Income Taxes. The provision for income taxes was $104,000, $71,000 and $3,000 in 2005, 2004 and 2003, respectively. The provision in 2005 and 2004 relates to alternative minimum tax liability. The provision in 2003 consists of minimum payments for state taxes. We have provided a valuation allowance on 100% of our deferred tax assets. We will continue to evaluate the recoverability of our deferred tax asset and the need for a valuation allowance against such asset. Factors that are considered in the evaluation of the recoverability of the deferred tax asset are continued profitability and our ability to meet our future forecasts. In general, any realization of our net deferred tax asset will reduce the effective rate in future periods. However, the realization of deferred tax assets that are related to net operating losses that were generated by tax deductions resulting from the exercise of non-qualified stock options, will result in a direct increase to stockholders’ equity.

Liquidity and Capital Resources

Since inception, we have financed our operations primarily through cash generated from operations and from net proceeds of $18.1 million generated by our initial public offering in 1995. On February 18, 2005, we entered into a Common Stock Purchase Agreement for the private placement of 3,500,000 shares of our common stock, $0.001 par value, at a price of $6.40 per share, resulting in aggregate gross cash proceeds to the Company of $22,400,000 before deducting commissions and other expenses. Offering costs related to the transaction totaled $1,613,000, comprised of $1,344,000 in commissions and $269,000 cash payments for legal and investment services, resulting in net proceeds to the Company of $20,786,000. The transaction closed simultaneously with the execution of the Purchase Agreement on February 18, 2005. C.E. Unterberg, Towbin LLC, the placement agent for the transaction, received a cash fee equal to 6% of the aggregate gross proceeds of the Private Placement.

Net cash provided by operations was $2.5 million in 2005 and $3.0 million in 2004. The primary source of operating cash in both periods was the net income and the increase in accounts payable and accrued liabilities, offset by the collection of accounts receivable.

Cash flows used in investing activities were $11 million in 2005 and $102,000 in 2004. This included $10.9 million for the purchase of Allume in July, 2005 as well as $142,000 for other capital expenditures. Our capital expenditures in both periods consisted of the purchase of computers and other office equipment.

We received $369,000 in cash from the exercise of employee stock options in 2005 compared to $2.0 million in 2004.

At December 31, 2005, we had $21.2 million in cash and cash equivalents and $25.3 million of working capital. We have no significant capital commitments, and currently anticipate that capital expenditures will not vary significantly from recent periods. We believe that our existing cash, cash equivalent investment balances and cash flow from operations will be sufficient to finance our working capital and capital expenditure requirements through at least the next twelve months. We may require additional funds to support our working capital requirements or for other purposes and may seek to raise additional funds through public or private equity or debt financing or from other sources. If additional financing is needed, we cannot assure that such financing will be available to us at commercially reasonable terms or at all.

Our corporate headquarters, which includes our principal administrative, sales and marketing, customer support and research and development facilities, is located in Aliso Viejo, California. We have leased this space through May 2009. We also lease approximately 7,700 square feet in Watsonville, California under a new lease that expires September 30, 2010. We are currently working on a new operating lease for our facility in Lee's Summit, Missouri to replace the lease that expired in June 2005.

As of December 31, 2005, we had no debt and no long term liabilities. The following table summarizes our contractual obligations as of December 31, 2005 (in thousands):

	Payments due by period				
Contractual obligations:	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Operating Lease Obligations	$ 1,934	$ 509	$ 1,025	$ 400	$ -
Purchase Obligations	2,202	2,202			
Total	$ 4,136	$ 2,711	$ 1,025	$ 400	$ -

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

Critical Accounting Policies

Our discussion and analysis of results of operations, financial condition and liquidity are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may materially differ from these estimates under different assumptions or conditions. On an on-going basis, we review our estimates to ensure that the estimates appropriately reflect changes in our business or new information as it becomes available.

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

Revenue Recognition - Software revenue is recognized in accordance with the Statement of Position ("SOP") 97-2, *Software Revenue Recognition,* as amended, when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectibility is probable. We recognize revenues from sales of our software to OEM 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 of SOP 97-2 are met. If the requirements of SOP 97-2 are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. Returns from OEM customers are limited to defective goods or goods shipped in error. Historically, OEM customer returns have not exceeded the very nominal estimates and reserves. Management reviews available retail channel information and makes a determination of a return provision for sales made to distributors and retailers based on current channel inventory levels and historical return patterns. Certain sales to distributors or retailers are made on a consignment basis. Revenue for consignment sales are not recognized until sell through to the final customer is established.

Product sales directly to end-users are recognized upon delivery. End users have a thirty day right of return, but such returns are reasonably estimable and have historically been immaterial. We also provide technical support to our customers. Such costs have historically been insignificant.

Service revenues include sales of consulting services, website hosting and fulfillment. We recognize service revenues as services are provided or as milestones are delivered and accepted by our customers.

Accounts Receivable – 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 a bad debt 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.

Goodwill – We have adopted SFAS No. 142, *Goodwill and Other Intangible Assets,* effective January 1, 2002 and no impairment was identified. As a result of the adoption, we are no longer required to amortize goodwill. Prior to the adoption of SFAS 142, goodwill was amortized over 7 years. In accordance with SFAS No. 142, we review the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. Our annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the estimated fair value of our reporting units to the carrying value of the underlying net assets in the reporting units. If the estimated fair value of a reporting unit is determined to be less than the fair 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 estimated fair value of the reporting unit and the fair value of its other assets and liabilities. We determined that we did not have any impairment of goodwill at December 31, 2005. Estimates of reporting unit fair value are based upon market capitalization and therefore are volatile being sensitive to market fluctuations. To the extent that our market capitalization decreases significantly or the allocation of value to our reporting units change, we could be required to write off some or all of our goodwill.

Deferred Income Taxes - We account for income taxes under SFAS No. 109, *Accounting for Income Taxes*. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in our financial statements or tax returns. The measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and the tax bases of our assets and liabilities result in a deferred tax asset, SFAS No. 109 requires an evaluation of the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized. We currently have a full valuation allowance on our deferred tax assets. Based on our assessment of all available evidence, we concluded that it is not more likely than not that our deferred tax assets will be realized. This conclusion is based primarily on our history of net operating losses as compared to only a recent trend of profitable operations, the potential for future stock option deductions to significantly reduce taxable income, annual net operating loss limitations under Section 382 of the Code and the need to generate significant amounts of taxable income in future periods on a consistent and prolonged basis in order to utilize the deferred tax assets. We will continue to monitor all available evidence and reassess the potential realization of our deferred tax assets. If we continue to meet our financial projections and improve our results of operations, or if circumstances otherwise change, it is possible that we may release all or a portion of our valuation allowance in the future. Any such release would result in recording a tax benefit that would increase net income in the period the valuation is released.

Recent Accounting Pronouncements

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* (SFAS NO. 156), which provides an approach to simplify efforts to obtain hedge-like (offset) accounting. This Statement amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Statement (1) requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations; (2) requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable; (3) permits an entity to choose either the amortization method or the fair value method for subsequent measurement for each class of separately recognized servicing assets or servicing liabilities; (4) permits at initial adoption a one-time reclassification of available-for-sale securities to trading securities by an entity with recognized servicing rights, provided the securities reclassified offset the entity's exposure to changes in the fair value of the servicing assets or liabilities; and (5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the balance sheet and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective for all separately recognized servicing assets and liabilities as of the beginning of an entity's fiscal year that begins after September 15, 2006, with earlier adoption permitted in certain circumstances. The Statement also describes the manner in which it should be initially applied. We do not believe that SFAS No. 156 will have a material impact on our financial position, results of operations or cash flows.

In February 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments*, which amends SFAS No. 133, *Accounting for Derivatives Instruments and Hedging Activities* and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. SFAS No. 155 amends SFAS No. 133 to narrow the scope exception for interest-only and principal-only strips on debt instruments to include only such strips representing rights to receive a specified portion of the contractual interest or principle cash flows. SFAS No. 155 also amends SFAS No. 140 to allow qualifying special-purpose entities to hold a passive derivative financial instrument pertaining to beneficial interests that itself is a derivative instrument. We are currently evaluating the impact this new Standard but believe that it will not have a material impact on our financial position, results of operations, or cash flows.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS No. 154), an amendment to Accounting Principles Bulletin Opinion No. 20, *Accounting Changes* (APB No. 20), and

SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. Though SFAS No. 154 carries forward the guidance in APB No.20 and SFAS No.3 with respect to accounting for changes in estimates, changes in reporting entity, and the correction of errors, SFAS No. 154 establishes new standards on accounting for changes in accounting principles, whereby all such changes must be accounted for by retrospective application to the financial statements of prior periods unless it is impracticable to do so. SFAS No. 154 is effective for accounting changes and error corrections made in fiscal years beginning after December 15, 2005, with early adoption permitted for changes and corrections made in years beginning after May 2005. We will implement SFAS No. 154 in its fiscal year beginning January 1, 2006. We are currently evaluating the impact of this new standard but believe that it will not have a material impact on our financial position, results of operations, or cash flows.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which replaces SFAS No. 123, *Accounting for Stock-Based Compensation* and supersedes APB No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first annual period after June 15, 2005, with early adoption encouraged. In addition, SFAS No. 123R will cause unrecognized expense (based on the amounts in our pro forma footnote disclosure) related to options vesting after the date of initial adoption to be recognized as a charge to results of operations over the remaining vesting period. We are required to adopt SFAS No. 123R in our first quarter of 2006, beginning January 1, 2006. Under SFAS No. 123R, we must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition alternatives include prospective and retroactive adoption methods. Under the retroactive methods, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and share awards at the beginning of the first quarter of adoption of SFAS No. 123R, while the retroactive methods would record compensation expense for all unvested stock options and share awards beginning with the first period restated. We are evaluating the requirements of SFAS No. 123R and we expect that the adoption of SFAS No. 123R will have a material impact on our consolidated results of operations and earnings per share. We have not determined the method of adoption or the effect of adopting SFAS No. 123R.

RISK FACTORS

Our future operating results are highly uncertain. Before deciding to invest in our common stock or to maintain or increase your investment, you should carefully consider the risks described below, in addition to the other information contained in this report and in our other filings with the SEC, including our reports on Forms 10-K, 10-Q and 8-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. If any of these risks actually occur, that could seriously harm our business, financial condition or results of operations. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

Our quarterly operating results may fluctuate and cause the price of our common stock to fall.

Our quarterly revenue and operating results have fluctuated significantly in the past and may continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. If our operating results do not meet the expectations of securities analysts or investors, our stock price may decline. Fluctuations in our operating results may be due to a number of factors, including the following:

- the size and timing of orders from and shipments to our major customers;
- the size and timing of any return product requests for our products;
- our ability to maintain or increase gross margins;

- variations in our sales channels or the mix of our product sales;
- the gain or loss of a key customer;
- our ability to specify, develop, complete, introduce, market and transition to volume production new products and technologies in a timely manner;
- the availability and pricing of competing products and technologies and the resulting effect on sales and pricing of our products;
- the effect of new and emerging technologies;
- deferrals of orders by our customers in anticipation of new products, applications, product enhancements or operating systems; and
- general economic and market conditions.

A large portion of our operating expenses, including rent, depreciation and amortization is fixed and difficult to reduce or change. Accordingly, if our total revenue does not meet our expectations, we may not be able to adjust our expenses quickly enough to compensate for the shortfall in revenue. In that event, our business, financial condition and results of operations would be materially and adversely affected.

Due to all of the foregoing factors, and the other risks discussed in this report, you should not rely on quarter-to-quarter comparisons of our operating results as an indication of future performance.

Although we have begun reporting backlog, our ability to predict our revenues and operating results is extremely limited.

We have historically operated with little backlog because we have generally shipped our software products and recognized revenue shortly after we received orders because our production cycle has traditionally been very short. As a result, our sales in any quarter were generally dependent on orders that were booked and shipped in that quarter. As our wireless business has evolved, production cycle time for items such as data kits has increased to the point that orders received towards the end of a quarter may not ship until the subsequent quarter. Additionally, customers may issue purchase orders that have extended delivery dates that may cause the shipment to fall in a subsequent quarter. These situations make it difficult for us to predict what our revenues and operating results will be in any quarter. Therefore, the level of backlog is not necessarily indicative of trends in our business. As of December 31, 2005, we had a backlog of approximately $4.0 million.

We depend upon a small number of customers for a significant portion of our revenues.

In the past we have derived a substantial portion of our revenues from sales to a small number of customers and expect to continue to do so in the future. The agreements we have with these entities do not require them to purchase any minimum quantity of our products and may be terminated by the entity or us at any time for any reason upon minimal prior written notice. Accordingly, we cannot be certain that these customers will continue to place large orders for our products in the future, or purchase our products at all. Our largest OEM customer accounted for 57.1%, 68.4% and 27.0% of our net revenues in the years ended December 31, 2005, December 31, 2004 and December 31, 2003, respectively. Our three largest OEM customers accounted for 63.5%, 77.8% and 47.9% in the years ended December 31, 2005, December 31, 2004 and December 31, 2003, respectively.

Our customers may acquire products from our competitors or develop their own products that compete directly with ours. Any substantial decrease or delay in our sales to one or more of these entities in any quarter would have an adverse effect on our results of operations. In addition, certain of our customers have in the past and may in the future acquire competitors or be acquired by competitors, causing further industry consolidation. In the past, such acquisitions have caused the purchasing departments of the combined companies to reevaluate their purchasing decisions. If one of our major customers engages in an acquisition in the future, it could change its current purchasing habits. In that event, we could lose the customer, or experience a decrease in orders from that customer or a delay in orders previously made by that customer. Further, although we maintain allowances for doubtful accounts, the insolvency of one or more of our major customers could result in a substantial decrease in our revenues.

Competition within our product markets is intense and includes numerous established competitors, which could negatively affect our revenues.

We operate in markets that are extremely competitive and subject to rapid changes in technology. Specifically, Microsoft Corporation poses a significant competitive threat to us because Microsoft operating systems may include some capabilities now provided by certain of our OEM and retail software products. If users are satisfied relying on the capabilities of the Windows-based systems or other operating systems, or other vendors products, sales of our products are likely to decline. In addition, because there are low barriers to entry into the software market, we expect significant competition from both established and emerging software companies in the future. Furthermore, many of our existing and potential OEM customers may acquire or develop products that compete directly with our products.

Microsoft and many of our other current and prospective competitors have significantly greater financial, marketing, service, support, technical and other resources than we do. As a result, they may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products. There is also a substantial risk that announcements of competing products by large competitors such as Microsoft or other vendors could result in the cancellation of orders by customers in anticipation of the introduction of such new products. In addition, some of our competitors currently make complementary products that are sold separately. Such competitors could decide to enhance their competitive position by bundling their products to attract customers seeking integrated, cost-effective software applications. Some competitors have a retail emphasis and offer OEM products with a reduced set of features. The opportunity for retail upgrade sales may induce these and other competitors to make OEM products available at their own cost or even at a loss. We also expect competition to increase as a result of software industry consolidations, which may lead to the creation of additional large and well-financed competitors. Increased competition is likely to result in price reductions, fewer customer orders, reduced margins and loss of market share.

Acquisitions of companies or technologies may disrupt our business and divert management attention and cause our current operations to suffer.

We recently acquired all the outstanding capital stock of Allume, Inc. (See Note 2 of Notes to Condensed Consolidated Financial Statements). We expect to continue to consider acquisitions of complementary companies, products or technologies. As part of any such acquisition, including that of Allume, Inc., we will be required to assimilate the operations, products and personnel of the acquired businesses and train, retain and motivate key personnel from the acquired businesses. We may be unable to maintain uniform standards, controls, procedures and policies if we fail in these efforts. Similarly, acquisitions may cause disruptions in our operations and divert management's attention from our company's day-to-day operations, which could impair our relationships with our current employees, customers and strategic partners. Acquisitions may also subject us to liabilities and risks that are not known or identifiable at the time of the acquisition.

We may also have to incur debt or issue equity securities in order to finance future acquisitions. The issuance of equity securities for any acquisition could be substantially dilutive to our existing stockholders. In addition, we expect our profitability could be adversely affected because of acquisition-related accounting costs and write offs.

In consummating acquisitions, we are also subject to risks of entering geographic and business markets in which we have had limited or no prior experience. If we are unable to fully integrate acquired businesses, products or technologies within existing operations, we may not receive the intended benefits of acquisitions.

If the adoption of new technologies and services grows more slowly than anticipated in our product planning and development, our future sales and profits may be negatively affected.

If the adoption of new technologies and services does not grow or grows more slowly than anticipated in our product planning and development, demand for certain of our products and services will be reduced. For example, our new QuickLink Mobile and QuickLink Enterprise products provide notebook users with the ability to roam between wireless wide area networks ("WWAN") and Wi-Fi hot spots. Therefore, future sales and any future profits from these and related products are substantially dependent upon the widespread acceptance and use of Wi-Fi as an effective medium of communication by consumers and businesses.

Our products may contain undetected software errors, which could negatively affect our revenues.

Our software products are complex and may contain undetected errors. In the past, we have discovered software errors in certain of our products and have experienced delayed or lost revenues during the period it took to correct these errors. Although we and our OEM customers test our products, it is possible that errors may be found in our new or existing products after we have commenced commercial shipment of those products. These undetected errors could result in adverse publicity, loss of revenues, delay in market acceptance of our products or claims against us by customers.

Technology and customer needs change rapidly in our market, which could render our products obsolete and negatively affect our revenue.

Our future success will depend on our ability to anticipate and adapt to changes in technology and industry standards. We will also need to continue to develop and introduce new and enhanced products to meet our customers' changing demands, keep up with evolving industry standards, including changes in the Microsoft operating systems with which our products are designed to be compatible, and to promote those products successfully. The communications and utilities software markets in which we operate are characterized by rapid technological change, changing customer needs, frequent new product introductions, evolving industry standards and short product life cycles. Any of these factors could render our existing products obsolete and unmarketable. In addition, new products and product enhancements can require long development and testing periods as a result of the complexities inherent in today's computing environments and the performance demanded by customers. If our software markets do not develop as we anticipate, or our products do not gain widespread acceptance in these markets or if we are unable to develop new versions of our software products that can operate on future operating systems, our business, financial condition and results of operations could be materially and adversely affected.

Delays or failure in deliveries from our component suppliers could cause our net revenue to decline and harm our results of operations.

We rely on third party suppliers to provide us with services and components for our product kits. These components include: compact discs; cables; printed manuals; and boxes. We do not have long-term supply arrangements with any vendor to obtain these necessary services and components for our products. If we are unable to purchase components from these suppliers or if the compact disc replication services that we use do not deliver our requirements on schedule, we may not be able to deliver products to our customers on a timely basis or enter into new orders because of a shortage in components. Any delays that we experience in delivering our products to customers could impair our customer relationships and adversely impact our reputation and our business. In addition, if our third party suppliers raise their prices for components or services, our gross margins would be reduced.

A shortage in the supply of wireless communication devices such as PC cards could adversely affect our revenues.

Our products are utilized with major wireless networks throughout the world that support data communications through the use of wireless communication devices such as PC cards. Since wireless network providers generally incorporate our products into the wireless communication devices that they sell directly to individual consumers, our future success depends upon the availability of such devices to consumers at reasonable prices. A shortage in the supply of wireless communication devices could put upward pressure on prices or limit the quantities available to individual consumers which could materially affect the revenues that we generate from our products.

We may be unable to adequately protect our intellectual property and other proprietary rights, which could negatively impact our revenues.

Our success is dependent upon our software code base, our programming methodologies and other intellectual properties and proprietary rights. In order to protect our proprietary technology, we rely on a combination of trade secret, nondisclosure and copyright and trademark law. We currently own United States trademark registrations for certain of our trademarks and United States patents for certain of our technologies, however, these measures afford us only limited protection. Furthermore, we rely primarily on "shrink wrap" licenses that are not signed by the end user and, therefore, may be unenforceable under the laws of certain jurisdictions. Accordingly, it is possible that third parties may copy or otherwise obtain our rights without our authorization. It is also possible that third parties may independently develop technologies similar to ours. It may be difficult for us to detect unauthorized use of our intellectual property and proprietary rights.

We may be subject to claims of intellectual property infringement as the number of trademarks, patents, copyrights and other intellectual property rights asserted by companies in our industry grows and the coverage of these patents and other rights and the functionality of software products increasingly overlap. From time to time, we have received communications from third parties asserting that our trade name or features, content, or trademarks of certain of our products infringe upon intellectual property rights held by such third parties. We have also received correspondence from third parties separately asserting that our fax products may infringe on certain patents held by each of the parties. Although we are not aware that any of our products infringe on the proprietary rights of others, third parties may claim infringement by us with respect to our current or future products. Infringement claims, whether with or without merit, could result in time-consuming and costly litigation, divert the attention of our management, cause product shipment delays or require us to enter into royalty or licensing agreements with third parties. If we are required to enter into royalty or licensing agreements, they may not be on terms that are acceptable to us. Unfavorable royalty or licensing agreements could seriously impair our ability to market our products.

Our stock price is highly volatile. Accordingly, you may not be able to resell your shares of common stock at or above the price you paid for them.

The market price of our common stock has fluctuated substantially in the past and is likely to continue to be highly volatile and subject to wide fluctuations. These fluctuations have occurred and may continue to occur in response to various factors, many of which we cannot control, including:

- quarter-to-quarter variations in our operating results;
- announcements of technological innovations or new products by our competitors, customers or us;
- market conditions within our retail and OEM software markets;
- general global economic and political instability;

- changes in earnings estimates or investment recommendations by analysts;
- changes in investor perceptions; or
- changes in expectations relating to our products, plans and strategic position or those of our competitors or customers.

In addition, the market prices of securities of high technology companies have been especially volatile. This volatility has significantly affected the market prices of securities of many technology companies. Accordingly, you may not be able to resell your shares of common stock at or above the price you paid. In the past, companies that have experienced volatility in the market price of their securities have been the subjects of securities class action litigation. If we were the object of a securities class action litigation, it could result in substantial losses and divert management's attention and resources from other matters.

If we are unable to retain key personnel, the loss of their services could materially and adversely affect our business, financial condition and results of operations.

Our future performance depends in significant part upon the continued service of our senior management and other key technical and consulting personnel. We do not have employment agreements with our key employees that govern the length of their service. The loss of the services of our key employees would materially and adversely affect our business, financial condition and results of operations. Our future success also depends on our ability to continue to attract, retain and motivate qualified personnel, particularly highly skilled engineers involved in the ongoing research and development required to develop and enhance our communication software products as well those in our highly specialized consulting business. Competition for these employees remains high and employee retention is a common problem in our industry. Our inability to attract and retain the highly trained technical personnel that are essential to our product development, consulting services, marketing, service and support teams may limit the rate at which we can generate revenue, develop new products or product enhancements and generally would have an adverse effect on our business, financial condition and results of operations. Additionally, retaining key employees during restructuring efforts is critical to our company's success.

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

We believe that the cash, cash equivalents and investments on hand and the cash we expect to generate from operations will be sufficient to meet our capital needs for at least the next twelve months. However, it is possible that we may need or choose to obtain additional financing to fund our activities. We could raise these funds by selling more stock to the public or to selected investors, or by borrowing money. We may not be able to obtain additional funds on favorable terms, or at all. If adequate funds are not available, we may be required to curtail our operations or other business activities significantly or to obtain funds through arrangements with strategic partners or others that may require us to relinquish right to certain technologies or potential markets. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock. We currently have no established line of credit or other business borrowing facility in place.

It is possible that our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will depend on many factors, including:

- the market acceptance of our products;

- the levels of promotion and advertising that will be required to launch our products and achieve and maintain a competitive position in the marketplace;
- our business, product, capital expenditure and research and development plans and product and technology roadmaps;
- the levels of inventory and accounts receivable that we maintain;
- capital improvements to new and existing facilities;
- technological advances;
- our competitors' response to our products; and
- our relationships with suppliers and customers.

In addition, we may require additional capital to accommodate planned growth, hiring, infrastructure and facility needs or to consummate acquisitions of other businesses, products or technologies.

Our business, financial condition and operating results could be adversely affected as a result of legal, business and economic risks specific to international operations.

Each year, a percentage of our revenues are derived from sales to customers outside the United States. This percentage can vary significantly from quarter to quarter and from year to year. We also frequently ship products to our domestic customers' international manufacturing divisions and subcontractors. In the future, we may expand these international business activities. International operations are subject to many inherent risks, including:

- general political, social and economic instability;
- trade restrictions;
- the imposition of governmental controls;
- exposure to different legal standards, particularly with respect to intellectual property;
- burdens of complying with a variety of foreign laws;
- import and export license requirements and restrictions of the United States and each other country in which we operate;
- unexpected changes in regulatory requirements;
- foreign technical standards;
- changes in tariffs;
- difficulties in staffing and managing international operations;
- difficulties in securing and servicing international customers;
- difficulties in collecting receivables from foreign entities; and
- potentially adverse tax consequences.

These conditions may increase our cost of doing business. Moreover, as our customers are adversely affected by these conditions, our business with them may be disrupted and our results of operations could be adversely affected.

The market price of our common stock may be adversely affected by the sale of significant numbers of shares of our

common stock by any of our principal stockholders.

A total of 3,500,000 shares of our common stock were sold in a private placement in February 2005. The associated registration statement for such shares became effective on June 17, 2005 In addition, there are other large blocks of shares held by individual stockholders which are eligible for resale under Rule 144, including William W. Smith, Jr., our President and Chief Executive Officer, who held 3,522,115 shares at March 9, 2006, and Rhonda L. Smith who held 2,314,115 shares. Overall, our trading volume fluctuates widely and at times is relatively limited. The market price for our common stock could decline as a result of the sale of a large number of the shares or the perception that such sales may occur. The sale of a large number of our common stock also might make it more difficult for us to sell equity or equity-related securities in the future at a time and at the prices that we deem appropriate.

We may be subject to regulatory scrutiny and may sustain a loss of public confidence if we are unable to satisfy regulatory requirements relating to internal controls over financial reporting.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to perform an evaluation of our internal controls over financial reporting and have our independent registered public accounting firm attest to such evaluation on an annual basis. Compliance with these requirements can be expensive and time-consuming. While we believe that we will be able to meet the required deadlines, no assurance can be given that we will meet the required deadlines in future years. If we fail to timely complete this evaluation, or if our auditors cannot timely attest to our evaluation, we may be subject to regulatory scrutiny and a loss of public confidence in our internal controls.

Provisions of our charter and bylaws and Delaware law could make a takeover of our company difficult.

Our certificate of incorporation and bylaws contain provisions that may discourage or prevent a third party from acquiring us, even if doing so would be beneficial to our stockholders. For instance, our certificate of incorporation authorizes the board of directors to fix the rights and preferences of shares of any series of preferred stock, without action by our stockholders. As a result, the board can authorize and issue shares of preferred stock, which could delay or prevent a change of control because the rights given to the holders of such preferred stock may prohibit a merger, reorganization, sale or other extraordinary corporate transaction. In addition, we are organized under the laws of the State of Delaware and certain provisions of Delaware law may have the effect of delaying or preventing a change in our control.

We may be subject to additional risks.

The risks and uncertainties described above are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also adversely affect our business operations.

Item 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Our financial instruments include cash and cash equivalents. At December 31, 2005, the carrying values of our financial instruments approximated fair values based on current market prices and rates. Because of their short duration, changes in market interest rates would not have a material effect on fair value.

It is our policy not to enter into derivative financial instruments. We do not currently have any significant foreign currency exposure as we do not transact business in foreign currencies. As such, we do not have significant currency exposure at December 31, 2005.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and schedule appear in a separate section of this Annual Report on Form 10-K beginning on page F-1 and S-1, respectively.

SUPPLEMENTARY FINANCIAL DATA

SELECTED QUARTERLY FINANCIAL DATA
STATEMENT OF OPERATIONS DATA
(UNAUDITED)

2005	Three Months Ended: March 31,	June 30,	September 30,	December 31,
	(in thousands, except per share amounts)			
Net Revenues	$ 2,030	$ 3,330	$ 6,896	$ 8,002
Gross Profit	1,685	2,785	5,731	5,954
Operating (Loss) Income	(228)	558	1,763	2,068
Net (Loss) Income	$ (128)	$ 764	$ 1,877	$ 2,211
Net (Loss) Income Per Share, Basic	$ (0.01)	$ 0.04	$ 0.09	$ 0.10
Weighted Average Shares Outstanding, Basic	19,665	21,584	22,016	22,106
Net (Loss) Income Per Share, Diluted	$ (0.01)	$ 0.03	$ 0.08	$ 0.09
Weighted Average Shares Outstanding, Diluted	21,009	22,713	23,222	23,900

2004	Three Months Ended: March 31,	June 30,	September 30,	December 31,
	(in thousands, except per share amounts)			
Net Revenues	$ 2,488	$ 3,117	$ 3,556	$ 4,155
Gross Profit	1,798	2,385	2,883	3,340
Operating Income	94	644	1,085	1,640
Net Income	$ 103	$ 634	$ 1,077	$ 1,631
Net Income Per Share, Basic	$ 0.01	$ 0.04	$ 0.06	$ 0.09
Weighted Average Shares Outstanding, Basic	17,024	17,072	17,254	17,706
Net Income Per Share, Diluted	$ 0.01	$ 0.04	$ 0.06	$ 0.09
Weighted Average Shares Outstanding, Diluted	18,042	18,022	18,617	19,125

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

Item 9A. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures*. Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Exchange Act). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective in timely alerting them to the material information related to us (or our consolidated subsidiaries) required to be included in the reports we file or submit under the Exchange Act.

(b) *Changes in Internal Controls*. During the most recent fiscal quarter covered by this report, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth certain information regarding our executive officers as of February 15, 2005.

Name	Age	Position
William W. Smith, Jr.	58	Chairman of the Board, President and Chief Executive Officer
Andrew C. Schmidt	44	Chief Financial Officer
David P. Sperling	37	Vice President and Chief Technical Officer
Jonathan Kahn	48	Senior Vice President
William R. Wyand	58	Vice President, Wireless and OEM Sales
Christopher G. Lippincott	35	Vice President, Internet and Direct Sales

Mr. Smith co-founded Smith Micro and has served as our Chairman of the Board, President and Chief Executive Officer since inception in 1982. Mr. Smith was employed by Rockwell International Corporation in a variety of technical and management positions from 1975 to 1984. Mr. Smith served with Xerox Data Systems from 1972 to 1975 and RCA Computer Systems Division from 1969 to 1972 in mainframe sales and pre-sale technical roles. Mr. Smith received a B.A. in Business Administration from Grove City College.

Mr. Schmidt joined the Company in June 2005 and serves as the Company's Chief Financial Officer. Prior to joining Smith Micro, Mr. Schmidt was the Chief Financial Officer of Genius Products, Inc., a publicly traded entertainment company from August 2004 to June 2005. From April 2003 to June 2004, he was Vice President (Finance) and acting Chief Accounting Officer of Peregrine Systems, Inc., a publicly held provider of enterprise level software then in Chapter 11 reorganization. From July 2000 to January 2003, he was Executive Vice President and Chief Financial Officer of Mad Catz Interactive, Inc., a publicly traded provider of console video game accessories. He holds a B.B.A. from the University of Texas and an M.S. in Accountancy from San Diego State University.

Mr. Sperling joined us in April 1989 and has been our Director of Software Engineering since April 1992. He assumed the Chief Technology Officer position in September 1999. Mr. Sperling began his professional career as a software engineer with us and he currently has three patents pending for various telephony and Internet technologies. Mr. Sperling earned a B.S. degree in Computer Science from the University of California, Irvine.

Mr. Kahn joined the company with the acquisition of Allume Systems, Inc. in July 2005. Prior to the acquisition, Mr. Kahn was President of the company. Mr. Kahn was one of the co-founders of Aladdin Systems, Inc. which later became Allume Systems. Mr. Kahn was Chairman, President and Chief Executive Officer of Monterey Bay Tech, Inc (OTC BB:MBYI), a public company from 1999 to May 2005 until its merger with SecureLogic Inc. Mr. Kahn is a member of the Digital River Advisory Board and is a graduate of the University of Rhode Island with a B.A. in Economics.

Mr. Wyand joined us in 1999 when Smith Micro acquired STF Technologies where Mr. Wyand was President and Chief Executive Officer. As General Manager he ran the Macintosh division sales, marketing, engineering and customer support efforts. Later that year, Mr. Wyand moved into the newly created Wireless and Broadband division as General Manager and in 2004 became Vice President, Wireless and OEM Sales. From 1995 to 1999, Mr. Wyand was President and Chief Executive Officer of STF Technologies. From 1984 to 1995, Mr. Wyand held various interim management and consulting positions. From 1977 to 1984, he held various positions with United Telecom Computer Group. From 1973 to 1977, he was a Consultant with Arthur Young & Co. He graduated with a B.S. from Pennsylvania State University and an MBA from Rockhurst College.

Mr. Lippincott joined us in 1993 as a senior sales representative. In 1998 he was appointed Director of North American Sales and in 2000 named General Manager of the Internet Solutions Division, then as Vice President, Internet and Direct Sales in 2004. Prior to joining Smith Micro, Mr. Lippincott held several retail sales positions. He attended the University of California at Berkeley majoring in business administration.

Officers are elected by, and serve at the discretion of, the Board of Directors.

Audit Committee; Audit Committee Financial Expert

Our Board of Directors has a standing Audit Committee. The members of the Audit Committee are Messrs. Campbell, Gulko and Szabo. Our Board has determined that Mr. Gulko, Chairman of the Audit Committee, is an audit committee financial expert as defined by Item 401(h) of Regulation S-K and that each member of the Audit Committee is independent within the meaning of Nasdaq Marketplace Rule 4200(a)(15).

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires certain of the company's executive officers, as well as its directors and persons who own more than then percent (10%) of a registered class of the Company's equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission.

Based solely on its review of the copies of such forms received by the Company, or written representations from certain reporting person, the Company believes that during the last fiscal year all executive officers and directors complied with their filing requirements under Section 16(a) for all reportable transactions during the year.

Code of Ethics

We have adopted a Code of Ethics that applies to all of our employees, including our principal executive officer, our principal financial officer, and all members of our finance department performing similar functions. Our Code of Ethics was filed as Exhibit 14 to the Annual Report on Form 10-K for the year ended December 31, 2003 which was filed on March 25, 2004. In the event of an amendment to, or a waiver from, certain provisions of our Code of Ethics, we intend, to the extent possible, to satisfy Form 8-K disclosure requirements by disclosing this information on our website at www.smithmicro.com.

Item 11. EXECUTIVE COMPENSATION

The section titled "Executive Compensation and Related Information" appearing in our Proxy Statement is hereby incorporated by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The section titled "Ownership of Securities" appearing in our Proxy Statement is hereby incorporated by reference.

Securities Authorized for Issuance Under An Equity Compensation Plan

The following table provides information as of December 31, 2005 with respect to the shares of common stock that may be issued under our existing equity compensation plan.

(In thousands, except per share amounts)	Number of Shares to be Issued Upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Shares Remaining Available for Future Issuance
Equity Compensation Plan Approved by Shareholders (1)	3,856	$3.57	2,764
Equity Compensation Plan Not Approved by Shareholders	0	0	0
Total	3,856	$3.57	2,764

(1) The number of shares to be issued upson exercise includes options granted under both the 1995 Stock Option/Stock Issuance Plan and the 2005 Stock Option/Stock Issuance Plan. The number of shares remaining available for future issuance consists only of the 2005 Plan.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The section titled "Related Party Transactions" appearing in our Proxy Statement is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The section titled "Ratification of Appointment of Independent Registered Public Accounting Firm – Principal Accountant Fees and Services" appearing in our Proxy Statement is incorporated herein by reference.

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

Smith Micro's financial statements appear in a separate section of this Annual Report on Form 10-K beginning on the pages referenced below:

(2) Financial Statement Schedule

Smith Micro's financial statement schedule appears in a separate section of this Annual Report on Form 10-K on the pages referenced below. All other schedules have been omitted as they are not applicable, not required or the information is included in the consolidated financial statements or the notes thereto.

(3) Exhibits

Exhibit No.	Title	Method of Filing
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	Incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement No. 33-95096.
3.1.1	Amendment to the Amended and Restated Certificate of Incorporation of the Registrant.	Incorporated by reference to Exhibit 3.1.1 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2000.
3.1.2	Certificate of Amendment to Amended and Restated Certificate of Incorporation of Registrant as filed August 18, 2005 with Delaware Secretary of State	Filed Herewith
3.2	Amended and Restated Bylaws of the Registrant.	Incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement No. 33-95096.
4.1	Specimen certificate representing shares of Common Stock of the Registrant.	Incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement No. 33-95096.

Exhibit No.	Title	Method of Filing
10.1	Form of Indemnification Agreement.	Incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement No. 33-95096.
10.2*	1995 Stock Option/Stock Issuance Plan as Amended and Restated through February 7, 2001.	Incorporated by reference to the Appendix attached to the Definitive Proxy Statement for the 2001 Annual Meeting of Stockholders filed on April 27, 2001.
10.3	2005 Stock Option / Stock Issuance Plan	Incorporated by reference to Appendix A attached to the Definitive Proxy Statement for the 2005 Annual Meeting as filed June 10, 2005.
10.4 †	Master Software License and Distribution Agreement (Contract No. 220-00-0134) effective as of December 1, 2000, between Cellco Partnership (d/b/a Verizon Wireless) and the Registrant	Incorporated by reference to Exhibit 10.1 to the Registrant’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2003.
10.4.1†	Amendment of Master Software License and Distribution Agreement (Contract No. 220-00-0134)	Incorporated by reference to Exhibit 10.1.1 to the Registrant’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2003.
10.4.2†	Amendment No. 2 to the Master Software License and Distribution Agreement (Contract No. 220-00-0134)	Incorporated by reference to Exhibit 10.1.2 to the Registrant’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2003.
14.1	Code of Ethics	Incorporated by reference to Exhibit 14.1 to the Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
14.1.1	Attachment 1 to Code of Ethics	Incorporated by reference to Exhibit 14.1 to the Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
21.1	Subsidiaries	Incorporated by reference to Exhibit 21.1 to the Registrant’s Annual Report on Form 10-K for the fiscal year ended December 31, 2000.
23.1	Consent of Independent Registered Public Accounting Firm.	Filed herewith
23.2	Consent of Independent Registered Public Accounting Firm.	Filed herewith
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32.1	Certifications of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of	Furnished herewith

Exhibit No.	Title	Method of Filing
	2002	

* Indicates management contract or compensatory plan or arrangement.

† Confidential treatment has been granted with respect to certain confidential portions of this exhibit pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, which confidential portions have been omitted from the exhibit and filed separately with the Securities and Exchange Commission.

(b) Exhibits

The exhibits filed as part of this report are listed above in Item 15(a) (3) of this Form 10-K.

(c) Financial Statement Schedule

The Financial Statement Schedule required by Regulation S-X and Item 8 of this Form are listed above in Item 15(a)(2) of this Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: March 31, 2006	By:/s/ William W. Smith, Jr. William W. Smith, Jr. Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)
Date: March 31, 2006	By:/s/ Andrew C. Schmidt Andrew C. Schmidt, Chief Financial Officer (Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ William W. Smith, Jr. William W. Smith, Jr.	Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)	March 31, 2006
/s/ Andrew C. Schmidt Andrew C. Schmidt	Chief Financial Officer (Principal Financial and Accounting Officer)	March 31, 2006
/s/ Thomas G. Campbell Thomas G. Campbell	Director	March 31, 2006
/s/ Samuel Gulko Samuel Gulko	Director	March 31, 2006
/s/ Ted Hoffman Ted Hoffman	Director	March 31, 2006
/s/ William C. Keiper William C. Keiper	Director	March 31, 2006
/s/Gregory J. Szabo Gregory J. Szabo	Director	March 31, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Smith Micro Software, Inc.:

We have audited the accompanying consolidated balance sheet of Smith Micro Software, Inc. and subsidiaries (the "Company") as of December 31, 2004, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the two years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2) for each of the two years in the period ended December 31, 2004. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Smith Micro Software, Inc. and subsidiaries as of December 31, 2004, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein for each of the two years in the period ended December 31, 2004.

DELOITTE & TOUCHE LLP
Costa Mesa, California
March 30, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Smith Micro Software, Inc.:

We have audited the accompanying consolidated balance sheet of Smith Micro Software, Inc. and subsidiaries (the "Company") as of December 31, 2005, and the related consolidated statements of operations, stockholders' equity and cash flows for year then ended. Our audit also included the financial statement schedule listed in the Index at Item 15(a)(2). These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Smith Micro Software, Inc. and subsidiaries as of December 31, 2005, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

SINGER LEWAK GREENBAUM & GOLDSTEIN LLP
Los Angeles, California
February 20, 2006

SMITH MICRO SOFTWARE INC., AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2005 AND 2004

(In thousands, except share and per share data)

	2005	2004
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$21,215	$ 8,634
Accounts receivable, net of allowances for doubtful accounts and other adjustments of $439 (2005) and $137 (2004)	6,786	2,024
Income tax receivable	--	35
Inventories, net	530	47
Prepaid expenses and other current assets	556	203
Total current assets	29,087	10,943
EQUIPMENT AND IMPROVEMENTS, net	241	113
INTANGIBLE ASSETS, net	4,093	--
GOODWILL	9,288	1,715
OTHER ASSETS, net	7	57
	$42,716	$12,828
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 2,383	$ 939
Accrued liabilities	1,376	790
Total current liabilities	3,759	1,729
COMMITMENTS AND CONTINGENCIES (Note 6)		
STOCKHOLDERS' EQUITY:		
Preferred stock, par value $0.001 per share; 5,000,000 shares authorized; none issued and outstanding		
Common stock, par value $0.001 per share; 50,000,000 shares authorized; 22,147,000 and 18,011,000 shares issued and outstanding	22	18
Additional paid-in capital	50,880	27,750
Accumulated deficit	(11,945)	(16,669)
Net stockholders' equity	38,957	11,099
	$42,716	$12,828

See notes to consolidated financial statements

SMITH MICRO SOFTWARE INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR EACH OF THE THREE YEARS
IN THE PERIOD ENDED DECEMBER 31, 2005

(In thousands, except per share data)

	Years ended December 31,		
	2005	2004	2003
NET REVENUES:			
Products	$ 19,637	$ 12,394	$ 6,291
Services	621	922	925
Total Net Revenues	20,258	13,316	7,216
COST OF REVENUES:			
Products	3,818	2,530	1,350
Services	285	380	321
Total Cost of Revenues	4,103	2,910	1,671
GROSS PROFIT	16,155	10,406	5,545
OPERATING EXPENSES:			
Selling and marketing	3,410	1,519	1,666
Research and development	3,963	2,556	2,506
General and administrative	4,621	2,868	2,330
Total operating expenses	11,994	6,943	6,502
OPERATING INCOME (LOSS)	4,161	3,463	(957)
INTEREST INCOME	667	53	37
INCOME (LOSS) BEFORE INCOME TAXES	4,828	3,516	(920)
INCOME TAX EXPENSE	104	71	3
NET INCOME (LOSS)	$ 4,724	$ 3,445	$ (923)
NET INCOME (LOSS) PER SHARE, basic	$ 0.22	$ 0.20	$ (0.06)
WEIGHTED AVG SHARES OUTSTANDING, basic	21,351	17,267	16,511
NET INCOME (LOSS) PER SHARE, fully diluted	$ 0.21	$ 0.19	$ (0.06)
WEIGHTED AVG SHARES OUTSTANDING, fully diluted	22,806	18,412	16,511

See notes to consolidated financial statements

SMITH MICRO SOFTWARE INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED DECEMBER 31, 2005

(In thousands)

	Common stock		Additional paid-in	Accumulated	
	Shares	Amount	capital	deficit	Total
BALANCE, December 31, 2002	16,227	$ 16	$ 24,787	$ (19,191)	$ 5,612
Exercise of common stock options	808	1	913		914
Repurchase and retirement of common stock	(24)		(13)		(13)
Net loss				(923)	(923)
BALANCE, December 31, 2003	17,011	17	25,687	(20,114)	5,590
Exercise of common stock options	1,000	1	1,995		1,996
Tax benefit related to the exercise of stock options			68		68
Net income				3,445	3,445
BALANCE, December 31, 2004	18,011	18	27,750	(16,669)	11,099
Issuance of common stock in private placement	3,500	4	20,782		20,786
Issuance of common stock in Allume acquisition	398		1,858		1,858
Exercise of common stock options	238		369		369
Tax benefit related to the exercise of stock options			20		20
Non cash compensation recognized on stock options			101		101
Net income				4,724	4,724
BALANCE, December 31, 2005	22,147	$ 22	$ 50,880	$ (11,945)	$ 38,957

See notes to consolidated financial statements

SMITH MICRO SOFTWARE INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR EACH OF THE THREE YEARS
IN THE PERIOD ENDED DECEMBER 31, 2005

(In thousands)

	Years ended December 31,		
	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$ 4,724	$ 3,445	$ (923)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	901	146	410
Provision for doubtful accounts and other adjustments to accounts receivable	573	112	132
Tax benefit related to the exercise of stock options	20	68	--
Non cash option expense	101	--	--
Change in operating accounts:			
Accounts receivable	(4,513)	(1,395)	(240)
Income tax receivable	35	(35)	--
Inventories	(246)	(25)	23
Prepaid expenses and other assets	(109)	(30)	(12)
Accounts payable and accrued liabilities	978	732	(157)
Net cash provided by (used in) operating activities	2,464	3,018	(767)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisition of Allume Systems, Inc.	(10,896)	--	--
Capital expenditures	(142)	(102)	(39)
Net cash used in investing activities	(11,038)	(102)	(39)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of common stock, net of offering costs	20,786	1,996	914
Proceeds from exercise of stock options	369	--	--
Cash used in repurchase of common stock	--	--	(13)
Net cash provided by financing activities	21,155	1,996	901
NET CHANGE IN CASH & CASH EQUIVALENTS	12,581	4,912	95
CASH AND CASH EQUIVALENTS, beginning of year	8,634	3,722	3,627
CASH AND CASH EQUIVALENTS, end of year	$21,215	$ 8,634	$ 3,722

See notes to consolidated financial statements

SMITH MICRO SOFTWARE INC., AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR EACH OF THE THREE YEARS
IN THE PERIOD ENDED DECEMBER 31, 2005 (Continued)

(In thousands)

	Year ended December 31,		
	2005	**2004**	**2003**
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION -			
Cash paid during the year for income taxes	$ 42	$ 38	$ 3

See notes to consolidated financial statements

SMITH MICRO SOFTWARE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR EACH OF THE THREE YEARS
IN THE PERIOD ENDED DECEMBER 31, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business - Smith Micro Software, Inc. and subsidiaries (the "Company") is a diversified developer and marketer of communications and utilities software products and services. The Company's strategic focus is to market and sell value-added wireless products targeted to the original equipment manufacturers ("OEM") market, particularly wireless service providers and mobile phone manufacturers as well as direct to corporations and consumers. The Company offers software products for Windows, Mac OSX, Unix and Linux operating systems. The Company also offers wireless communication software products and services to the enterprise market that include enhanced wireless security features.

On July 1, 2005, the Company acquired Allume Systems ("Allume"), which was a wholly owned subsidiary of International Microcomputer Software, Inc. (see Note 4). Allume develops and publishes award-winning software solutions that empower users in the area of information access, removal, recovery, security, productivity and online distribution. Allume's flagship product is StuffIt® Deluxe. StuffIt Wireless, a new and advanced technology that is patent pending by Allume Systems, will compress an already compressed JPEG file by up to 30% more without loosing any of the picture quality. This technology is particularly important to mobile phone manufactures who now can store up to 30% more images and carriers who are interested in the reduction of utilized bandwidth. Other award winning products include icSpyware Suite® and Internet Cleanup® which targets spyware and phishing intrusions, and Spring Cleaning® which cleans and optimizes computer operating systems.

Basis of Presentation - The accompanying consolidated financial statements reflect the operating results and financial position of Smith Micro Software, Inc. and its wholly owned subsidiaries in accordance with accounting principles generally accepted in the United States of America. All intercompany amounts have been eliminated in consolidation.

Cash and Cash Equivalents - Cash and cash equivalents generally consist of cash, government securities and money market funds. These securities are primarily held in one financial institution and are uninsured except for minimum FDIC coverage. As of December 31, 2005 and December 31, 2004, balances totaling approximately $21.4 million and $8.5 million, respectively, were uninsured. All have original maturity dates of three months or less.

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

Inventories - Inventories consist principally of cables, CDs, boxes and manuals and are stated at the lower of cost (determined by the first-in, first-out method) or market. The Company regularly reviews its inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on management's estimated forecast of product demand and production requirements.

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.

Long Lived Assets - The Company accounts for the impairment and disposition of long-lived assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. This statement addresses financial accounting and reporting for the impairment of long-lived assets and for the disposal of long-lived assets. In accordance with SFAS No. 144, long-lived assets to be held are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. The Company periodically reviews the carrying value of long-lived assets to determine whether or not an impairment to such value has occurred. The Company has determined that there was no impairment at December 31, 2005.

Goodwill - The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets,* effective January 1, 2002 and no impairment was identified. As a result of the adoption, the Company is no longer required to amortize goodwill. In accordance with SFAS No. 142, the Company reviews the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. The Company's annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the fair value of the Company's reporting units to the carrying value of the underlying net assets in the reporting units. If the fair value of a reporting unit is determined to be less than the carrying value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the fair value of the reporting unit and the fair value of its other assets and liabilities. The Company determined that it did not have any impairment of goodwill at December 31, 2005.

Revenue Recognition - Software revenue is recognized in accordance with the Statement of Position ("SOP") 97-2, *Software Revenue Recognition,* as amended, when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, and collection is probable. The Company recognizes revenues from sales of its software to Retail and OEM customers or end users as completed products are shipped and title passes, or from royalties generated as authorized customers duplicate its software, if the other requirements of SOP 97-2 are met. If the requirements of SOP 97-2 are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. Returns from Retail and OEM customers are limited to defective goods or goods shipped in error. Historically, OEM customer returns have not been significant. The Company 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 are made on a consignment basis. Revenue for consignment sales is not recognized until sell through to the final customer has occurred.

Product sales directly to end users are recognized upon delivery. End users have a thirty day right of return, but such returns are reasonably estimable and have historically been immaterial. The Company also provides technical support to its customers. Such costs have historically been insignificant.

Service revenues include sales of consulting services, web site hosting and fulfillment. Service revenues are recognized as services are provided or as milestones are delivered and accepted by our customers.

Software Development Costs - Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. The Company considers technological feasibility to be established when all planning, designing, coding and testing has been completed according to design specifications. After technological feasibility is established, any additional costs are capitalized. Through December 31, 2005, software has been substantially completed concurrently with the establishment of technological feasibility; and, accordingly, no costs have been capitalized to date.

Sales Incentives - Pursuant to the consensus of EITF 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Product),* effective January 1, 2002, the cost of sales incentives the Company offers without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction is accounted for as a reduction of revenue.

Advertising Expense - Advertising costs are expensed as incurred. Advertising expenses were $223,000, $47,000 and $95,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

Income Taxes - The Company accounts for income taxes under SFAS No. 109, *Accounting for 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. The measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and the tax bases of the Company's assets and liabilities result in a deferred tax asset, SFAS No. 109 requires an evaluation of the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized. The federal and state current provision relates to alternative minimum tax liability.

Stock-Based Compensation - The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* and related interpretations. SFAS No. 123*, Accounting for Stock-Based Compensation,* requires the disclosure of pro forma net income (loss) and income (loss) per share had the Company adopted the fair value method as of the beginning of fiscal 1995. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values.

The Company's calculations were made using the Black-Scholes option pricing model with the following weighted average assumptions: expected life, 12 to 48 months following grant date; stock volatility, 85%, 127% and 125% for grants issued in 2005, 2004 and 2003, respectively; risk-free interest rates of 3.98%, 3.47% and 2.63% for 2005, 2004 and 2003, respectively; and no dividends during the expected term. The Company's calculations are based on a single-option valuation approach, and forfeitures or cancellations are recognized as they occur. If the computed fair values of the 2005, 2004 and 2003 awards had been amortized to expense over the vesting period of the awards, pro forma net income (loss) would have been as follows:

	Year Ended December 31,		
	2005	2004	2003
(in thousands, except per share data)			
Net income (loss):			
Net income (loss), as reported	$ 4,724	$ 3,445	$ (923)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,582)	(308)	(286)
Pro forma net income (loss)	$ 3,142	$ 3,137	$ (1,209)
Income (loss) per Common Share			
As reported, Basic	$ 0.22	$ 0.20	$ (0.06)
As reported, Diluted	$ 0.21	$ 0.19	$ (0.06)
Pro forma, Basic	$ 0.15	$ 0.18	$ (0.07)
Pro forma, Diluted	$ 0.14	$ 0.17	$ (0.07)

Beginning in fiscal 2006, we will be adopting FAS 123R, which requires the expensing of stock options. Taking into account options issued and outstanding at December 31, 2005, we estimate that our 2006 stock compensation expense would be approximately $2.6 million. New option issuances or restricted stock grants made in fiscal 2006 would increase the estimate.

Net Income (Loss) per Share - Pursuant to SFAS No. 128, *Earnings per Share,* the Company is required to provide dual presentation of "basic" and "diluted" earnings (loss) per share (EPS). Basic EPS amounts are based upon the weighted average number of common shares outstanding. Diluted EPS amounts are based upon the weighted average number of common and potential common shares outstanding. Potential common shares include stock options using the treasury stock method. Potential common shares are excluded from the calculation of diluted EPS in loss years, as the impact is antidilutive. Potential common shares of 955,000 have been excluded from diluted weighted average common shares for the year ended December 31, 2003.

Fulfillment Services - The Company currently holds consigned inventory from a customer, which is used to fulfill orders. As the Company does not hold title to the inventory, it is not recorded in the accompanying consolidated balance sheets. In addition, the Company receives cash for fulfillment orders, which is paid out to the fulfillment customer on a monthly basis. Such cash and the related payable are recorded on a net basis as the amounts are held for the benefit of this fulfillment customer. Revenue is recognized for fulfillment services as services are performed.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions 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 years. Actual results could differ from those estimates.

Comprehensive Income(Loss) - Comprehensive income, as defined, includes all changes in equity (net assets) during a period from non-owner sources. For each of the years ended December 31, 2005, 2004 and 2003, there was no difference between net income (loss) and comprehensive income (loss).

Fair Value of Financial Instruments - The Company's financial instruments consist of cash, cash equivalents and trade receivables and payables. The carrying amounts of these instruments approximate fair value because of their short-term maturities.

New Accounting Pronouncements - In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* (SFAS No. 156), which provides an approach to simplify efforts to obtain hedge-like (offset) accounting. This Statement amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Statement (1) requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations; (2) requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable; (3) permits an entity to choose either the amortization method or the fair value method for subsequent measurement for each class of separately recognized servicing assets or servicing liabilities; (4) permits at initial adoption a one-time reclassification of available-for-sale securities to trading securities by an entity with recognized servicing rights, provided the securities reclassified offset the entity's exposure to changes in the fair value of the servicing assets or liabilities; and (5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the balance sheet and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS No. 156 is effective for all separately recognized servicing assets and liabilities as of the beginning of an entity's fiscal year that begins after September 15, 2006, with earlier adoption permitted in certain circumstances. The Statement also describes the manner in which it should be initially applied. The Company does not believe that SFAS No. 156 will have a material impact on its financial position, results of operations or cash flows.

In February 2006, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 155, *Accounting for Certain Hybrid Financial Instruments*, which amends SFAS No. 133, *Accounting for Derivatives Instruments and Hedging Activities* and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. SFAS No. 155 amends SFAS No. 133 to narrow the scope exception for interest-only and principal-only strips on debt instruments to include only such strips representing rights to receive a specified portion of the contractual interest or principle cash flows. SFAS No. 155 also amends SFAS No. 140 to allow qualifying special-purpose entities to hold a passive derivative financial instrument pertaining to beneficial interests that itself is a derivative instrument. The Company is currently evaluating the impact this new Standard but believe that it will not have a material impact on the Company's financial position, results of operations, or cash flows.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS No. 154), an amendment to Accounting Principles Bulletin Opinion No. 20, *Accounting Changes* (APB No. 20), and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. Though SFAS No. 154 carries forward the guidance in APB No.20 and SFAS No.3 with respect to accounting for changes in estimates, changes in reporting entity, and the correction of errors, SFAS No. 154 establishes new standards on accounting for changes in accounting principles, whereby all such changes must be accounted for by retrospective application to the financial statements of prior periods unless it is impracticable to do so. SFAS No. 154 is effective for accounting changes and error corrections made in fiscal years beginning after December 15, 2005, with early adoption permitted for changes and corrections made in years beginning after May 2005. The Company will implement SFAS No. 154 in its fiscal year beginning January 1, 2006. The Company is currently evaluating the impact of this new standard but believes that it will not have a material impact on the Company's financial position, results of operations, or cash flows.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which replaces SFAS No. 123, *Accounting for Stock-Based Compensation* and supersedes APB No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first annual period after June 15, 2005, with early adoption encouraged. In addition, SFAS No. 123R will cause unrecognized expense (based on the amounts in our pro forma footnote disclosure) related to options vesting after the date of initial adoption to be recognized as a charge to results of operations over the remaining vesting period. The Company is required to adopt SFAS No. 123R in the first quarter of 2006, beginning January 1, 2006. Under SFAS No. 123R, the Company will determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at the date of adoption. The transition alternatives include prospective and retroactive adoption methods. Under the retroactive methods, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and share awards at the beginning of the first quarter of adoption of SFAS No. 123R, while the retroactive methods would record compensation expense for all unvested stock options and share awards beginning with the first period restated. The Company is evaluating the requirements of SFAS No. 123R and expects that the adoption of SFAS No. 123R will have a material impact on its consolidated results of operations and earnings per share. The Company has not determined the method of adoption or the effect of adopting SFAS No. 123R.

2. ACQUISITION OF ALLUME INC.

On July 1, 2005, the Company acquired 100% of the issued and outstanding capital stock of Allume, Inc. from International Microcomputer Software, Inc. (IMSI) for $10.6 million in cash and 397,547 restricted shares of its common stock. Allume, Inc. is a leading developer of compression software solutions for JPEG, MPEG and MP3 platforms. A portion of the purchase price, including $1,250,000 cash and shares of common stock having a market value of $750,000 were deposited in an indemnity escrow to secure certain representations and warranties included in the Stock Purchase Agreement. The aggregate purchase price was approximately $12.8 million, which includes $10.6 million cash paid, the 397,547 shares issued, which have been valued using the average closing market price of the Company's common stock over the two-day period before and after the sale was announced, and $316,000 of direct acquisition costs. The direct acquisition costs incurred to date include $116,000 for legal and professional services, as well as a transaction fee of $200,000.

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

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

Cash consideration	$10,626
Common stock	1,858
Acquisition related costs	316
Total purchase price	$12,800

The purchase price is contingent upon a final calculation of Allume's net assets. If the final net asset calculation is less than the minimum amount specified in the purchase agreement, the purchase price will be adjusted downward accordingly. Any such adjustment will be recorded as an adjustment to the cost of Allume Systems, Inc. and reflected in the final purchase price allocation.

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

Assets:		
	Cash	$ 46
	Accounts Receivable, net	822
	Inventories, net	237
	Property & Equipment	67
	Other Assets	244
	Intangible Assets	4,863
	Goodwill	7,573
	Total Assets	13,852
Liabilities:		
	Accounts Payable	659
	Accrued Liabilities	393
	Total Liabilities	1,052
	Total purchase price	$ 12,800

Unaudited pro forma consolidated results of operations for the years ended December 31, 2005 and 2004 as if the acquisition had occurred as of January 1, 2004 are as follows (in thousands, except per share data):

	Year Ended December 31, 2005		Year Ended December 31, 2004	
	Historical	Proforma	Historical	Proforma
Net Revenues	$ 20,258	$ 24,647	$ 13,316	$ 22,902
Net Income	$ 4,724	$ 4,288	$ 3,445	$ 2,810
Net Income per share, basic	$ 0.22	$ 0.20	$ 0.20	$ 0.16
Net Income per share, diluted	$ 0.21	$ 0.19	$ 0.19	$ 0.15
Weighted average shares outstanding, basic	21,351	21,549	17,267	17,665
Weighted average shares outstanding, diluted	22,806	23,004	18,412	18,810

Pro forma adjustments have been applied to reflect the addition of amortization related to the intangible assets and the fixed assets acquired and reduction in interest income as if the acquisition had occurred at the beginning of such period presented. The pro forma adjustment for amortization related to intangible assets acquired was $$1.5 million and $608,000 for the proforma periods ending December 31, 2004 and 2005, respectively.

3. EQUIPMENT AND IMPROVEMENTS

Equipment and improvements consist of the following (in thousands):

	December 31, 2005	December 31, 2004
Machinery and equipment	$ 906	$ 745
Leasehold improvements	362	315
Office furniture and fixtures	72	107
	1,340	1,167
Less accumulated depreciation and amortization	(1,099)	(1,054)
	$ 241	$ 113

4. GOODWILL AND OTHER INTANGIBLE ASSETS

The following table sets forth the acquired intangible assets by major asset class:

	Useful	December 31, 2005			December 31, 2004		
	Life (Years)	Gross	Accumulated Amortization	Net Book Value	Gross	Accumulated Amortization	Net Book Value
(in thousands)							
Amortizing:							
Purchased and Licensed Technology	3	$ 2,260	$ (2,260)	$ -	$ 2,260	$ (2,260)	$ -
Capitalized Software	5	2,649	(534)	2,115	-	-	-
Distribution Rights	5	482	(76)	406	-	-	-
Customer Lists	5	923	(92)	831	-	-	-
Trademarks	10	809	(68)	741	-	-	-
Totals		$ 7,123	$ (3,030)	$ 4,093	$ 2,260	$ (2,260)	$ -

Aggregate amortization expense on intangible assets was approximately $770,000, $40,000 and $184,000 for the years ended December 31, 2005, 2004 and 2003, respectively. Expected future amortization expense is as follows: $1,378,000 for the year 2006, $1,074,000 for the year 2007, $743,000 for the year 2008, $449,000 for the year 2009 and $449,000 thereafter.

The carrying amount of the Company's goodwill was $9,288,000 as of December 31, 2005 and $1,715,000 as of December 31, 2004. The Company's reporting units are equivalent to its operating segments. At December 31, 2005 and 2004, the amount of goodwill allocated to the products segment is $8,953,000 and $1,380,000, respectively and the amount of goodwill allocated to the services segment is $335,000.

5. ACCRUED LIABILITIES

Accrued liabilities consist of the following (in thousands):

	December 31,	
	2005	2004
Salaries and benefits	$ 1,055	$ 783
Royalties	180	1
Marketing expenses and rebates	103	-
Other	38	6
	$1,376	$ 790

6. INCOME TAXES

A summary of the income tax expense (benefit) is as follows (in thousands):

	Year ended December 31,		
	2005	**2004**	**2003**
Current:			
Federal	$ 100	$ 68	$ -
State	4	3	3
	104	71	3
Deferred:			
Federal	1,286	1,025	(324)
State	(197)	427	(22)
Change in valuation allowance	(1,089)	(1,452)	346
	0	0	0
	$ 104	$ 71	$ 3

A reconciliation of the provision (benefit) for income taxes to the amount of income tax expense (benefit) that would result from applying the federal statutory rate (35%) to the income (loss) before income taxes is as follows:

	December 31,		
	2005	2004	2003
Federal statutory rate	35 %	35 %	(35)%
State tax, net of federal benefit	3	--	--
Nondeductible expense related to acquired intangibles	--	--	(2)
Other	(1)	(1)	2
Change in valuation allowance	(35)	(32)	35
	2 %	2 %	0 %

The major components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	December 31,	
	2005	2004
Various reserves	$ 107	$ 91
Nondeductible accruals	204	112
State taxes	(587)	(523)
Prepaid expenses	(99)	(71)
Credit carryforwards	1,687	1,320
Net operating loss carryforwards	6,118	7,652
Fixed Assets	48	36
Amortization	265	258
Other	43	0
Subtotal	7,786	8,875
Valuation allowance	(7,786)	(8,875)
	$ 0	$ 0

The Company has federal and state net operating loss carryforwards of approximately $14,896,000 and $12,034,000, respectively, at December 31, 2005. These federal and state net operating loss carryforwards will expire in 2006 through 2025. In addition, the Company has federal and state tax credit carryforwards of approximately $1,128,000 and $559,000, respectively, at December 31, 2005. These tax credits will begin to expire in 2010.

As of December 31, 2005 and 2004 a valuation allowance of approximately $7,786,000 and $8,875,000 respectively, has been provided based on the Company's assessment that it is more likely than not that sufficient taxable income will not be generated to realize the tax benefits of these temporary differences. For the years ended December 31, 2005 and 2004, the net change in the valuation allowance was a decrease of $1,089,000 and $1,452,000, respectively.

As of December 31, 2005, a valuation allowance of approximately $7,786,000 has been provided based upon the Company's assessment that it is more likely than not that sufficient taxable income will not be generated to realize the tax benefits of these temporary differences.

The increases in the valuation allowance for 2005 and 2004 includes $401,000 and $1,710,000, respectively, related to the increases in the Company's Net Operating Loss Carryforwards as a result of tax deductions derived from the exercise of stock options. Cumulatively, as of December 31, 2005, approximately $3,752,000 of the valuation allowance was attributable to such potential tax benefit of stock option transactions that will be credited directly to additional paid in capital, if realized.

7. COMMITMENTS AND CONTINGENCIES

Leases - The Company has non-cancelable operating leases for its building facilities in Aliso Viejo, California and Watsonville, California, which expire in May 2009 and September 2010, respectively. The Company also leases space for its facility in Lee's Summit, Missouri on a month to month basis. Future minimum rental commitments consist of the following (in thousands):

Year ending December 31:	
2006	$ 509
2007	512
2008	514
2009	295
2010	104
Total	$ 1,934

Total rent expense was $492,000, $480,000 and $590,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

Litigation – From time to time the Company is subject to litigation in the normal course of business, none of which management believes will likely have a material adverse effect on the Company's consolidated financial condition or results of operations.

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.

8. SEGMENT INFORMATION

The Company currently operates in two business segments: products and services. In addition, revenues are classified into three markets, Wireless and OEM sales, Retail and Distribution sales, and Internet and Direct sales. Our Internet market includes Internet based software products as well as consulting, fulfillment and hosting revenue.

The Company does not separately allocate operating expenses to these segments, nor does it allocate specific assets to these segments. Therefore, segment information reported includes only revenues and cost of revenues.

The following table shows the net revenues and cost of revenues generated by each segment:

	Year Ended December 31,					
	2005		2004		2003	
	Products	Services	Products	Services	Products	Services
Wireless & OEM	$ 13,954	$ -	$ 11,424	$ -	$ 4,711	$ -
Retail & Distribution	$ 4,886	-	-	-	-	-
Internet & Direct	797	621	970	922	1,580	925
Total Revenues	19,637	621	12,394	922	6,291	925
Cost of revenues	3,818	285	2,530	380	1,350	321
Gross Profit	$ 15,819	$ 336	$ 9,864	$ 542	$ 4,941	$ 604

Sales to individual customers and their affiliates, which amounted to more than 10% of the Company’s net revenues, included one OEM customer at 57.1% in 2005, one OEM customer at 68.4% of revenues in 2004 and three OEM customers at 27.0%, 10.7% and 10.2% of revenues in 2003. Accounts receivable from these customers were $4.6 million at December 31, 2005, $1.7 million at December 31, 2004 and $477,000, $55,000 and $0 at December 31, 2003. A decision by a significant customer to substantially decrease or delay purchases from the Company or the Company's inability to collect receivables from these customers could have a material adverse effect on the Company's consolidated financial condition and results of operations.

9. PROFIT SHARING

The Company offers its employees a 401(k) plan, in which the Company matches the employee contribution at a rate of 20%, subject to a vesting schedule. Total employer contributions amounted to $65,000, $54,000 and $45,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

10. STOCK-BASED COMPENSATION

On July 28, 2005, the Shareholders approved the 2005 Stock Option / Stock Issuance Plan. The Plan, which became effective the same date, replaced the 1995 Stock Option / Stock Issuance Plan which expired on May 24, 2005. All outstanding options under the 1995 Plan will remain outstanding, but no further grants will be made under that Plan. The maximum number of shares of the Company's Common Stock available for issuance over the term of the 2005 Plan may not exceed 5,000,000 shares, plus that number of additional shares equal to 2.5% of the number of shares of Common Stock outstanding on the last trading day of the calendar year commencing with calendar year 2006 (but not in excess of 750,000 shares). Under the terms of the Plan, incentive and nonqualified options may be granted at an exercise price not less than the fair market value on the grant date, with terms of up to 10 years, and with vesting to be determined by the Board of Directors.

Stock option activity under the Plan is as follows:

	Number of options	Weighted average exercise price
OUTSTANDING, December 31, 2002 (1,535,000 options, exercisable at weighted average exercise price of $2.15)	2,765,000	$ 1.46
Granted (weighted average fair value of $2.22)	38,000	$ 2.46
Exercised	(808,000)	$ 1.13
Canceled	(84,000)	$ 1.43
OUTSTANDING, December 31, 2003 (1,140,000 options, exercisable at weighted average exercise price of $2.43)	1,911,000	$ 1.62
Granted (weighted average fair value of $1.70)	922,000	$ 1.95
Exercised	(1,000,000)	$ 2.00
Canceled	(34,000)	$ 1.74
OUTSTANDING, December 31, 2004 (479,000 options, exercisable at weighted average exercise price of $2.12)	1,799,000	$ 1.58
Granted (weighted average fair value of $2.75)	2,371,000	$ 4.94
Exercised	(238,000)	$ 1.55
Canceled	(76,000)	$ 5.22
OUTSTANDING, December 31, 2005 (898,000 options, exercisable at weighted average exercise price of $1.85)	3,856,000	$ 3.57

Additional information regarding options outstanding as of December 31, 2005 is as follows:

		Options outstanding		Options exercisable	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable	Weighted average exercise price
$0.24 - $ 0.50	433,000	6.9	$ 0.24	245,000	$ 0.24
$0.51 - $ 1.00	123,000	6.3	$ 0.93	121,000	$ 0.94
$1.01 - $ 2.00	881,000	8.2	$ 1.84	315,000	$ 1.73
$2.01 - $ 4.00	159,000	8.7	$ 3.62	155,000	$ 3.65
$4.01 - $ 5.00	2,160,000	9.6	$ 4.95	36,000	$ 4.95
$5.01 - $14.00	100,000	8.4	$ 6.78	26,000	$ 7.44
	3,856,000	8.8	$ 3.57	898,000	$ 1.85

At December 31, 2005, 2,764,000 shares were available for future grants under the Stock Option Plan.

11. RELATED PARTY TRANSACTIONS

In October 2004, the Company entered into a Master Software Services Agreement with Arrange Technology LLC, providing for the development of certain software applications and integration services. A member of the Company’s Board of Directors was a principal beneficial owner of Arrange Technology LLC, however, that relationship terminated in 2005. $118,000 and $19,000 was expensed under the terms of the agreement in the years ended December 31, 2005 and 2004, respectively.

In conjunction with the severance agreement, entered into in June 2005, with Robert Scheussler, the former CFO, the Company recognized approximately $230,000 in severance related costs which is included in general and administrative expenses in the consolidated statement of operations for the year ended December 31, 2005. As per the agreement, Mr. Scheussler will continue to provide services to the Company as a consultant and, under the terms of the Company's Stock Option Plan, will continue to vest in his existing, unvested option grants (which were not modified) totaling 108,333 options. The unvested portion of these option grants were valued by the Company at approximately $424,000 on July 1, 2005, utilizing the Black Scholes option pricing model. The Company expensed approximately $101,000 in the year ended December 31, 2005 with respect to Mr. Scheussler's employee stock option agreements.

In September 2004, the Company entered into a severance agreement with a principal stockholder and former officer and director of the Company. The Company has discharged its obligation under the agreement by purchasing a single premium annuity in the amount of $192,000 which is included in general and administrative expenses in the consolidated statement of operations for the year ended December 31, 2004.

12. EQUITY TRANSACTIONS

On February 18, 2005, the Company entered into a Securities Purchase Agreement with certain institutional investors related to the private placement of 3,500,000 shares of our common stock, par value $0.001 per share. The transaction closed on February 18, 2005 and the Company realized gross proceeds of $22.4 million from the financing before deducting commissions and other expenses. Offering costs related to the transaction totaled $1,613,000, comprised of $1,344,000 in commissions and $269,000 cash payments for legal and investment services, resulting in net proceeds of $20,786,000. The Company agreed to register for resale the shares of Common Stock issued in the private placement. Such registration statement became effective on June 17, 2005. The agreement provides for penalties of one percent (1%) of the purchase price per month should effectiveness of the registration not be maintained

C.E. Unterberg, Towbin LLC, the placement agent for the transaction, received a cash fee equal to 6% of the aggregate gross proceeds of the Private Placement.

On July 28, 2005, the Shareholders approved a proposal to amend the Amended and restated Certificate of Incorporation to increase the number of authorized Common Shares from 30,000,000 to 50,000,000. Increasing the number of authorized shares of Common Stock is expected to provide the Company with additional capital resources to finance the long-term growth of the Company and with sufficient shares of Common Stock for stock splits. The additional shares of Common Stock could be issued for acquisitions and in public or private offerings, the proceeds of which could be used to finance the Company’s growth through increased working capital, expansion of existing businesses and other corporate purposes. .

SMITH MICRO SOFTWARE INC. AND SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS
FOR EACH OF THE THREE YEARS
IN THE PERIOD ENDED DECEMBER 31, 2005

(In thousands)

	Balance at beginning of period	Additions charged to costs and expenses	Deductions	Balance at end of period
Allowance for doubtful accounts and other adjustments (1):				
2005	$ 137	$ 573	$ (271)	$ 439
2004	33	112	(8)	137
2003	565	132	(664)	33

(1) Other adjustments relate principally to sales returns.

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-02418, 333-40106, 333-62134, 333-121330, 333-123042 and 333-129132 on Form S-8 and Registration Statement Nos. 333-123821 and 333-128695 on Form S-3 of our report dated March 30, 2005, relating to the consolidated financial statements and financial statement schedule of Smith Micro Software, Inc. as of December 31, 2004 and for each of the two years in the period ended December 31, 2004, appearing in this Annual Report on Form 10-K of Smith Micro Software, Inc. for the year ended December 31, 2005.

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DELOITTE & TOUCHE LLP
Costa Mesa, California
March 31, 2006

EXHIBIT 23.2

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement (Nos. 333-02418, 333-40106, 333-62134, 333-121330 and 333-123042 and 333-129132) on Form S-8 and Registration Statement (Nos. 333-123821 and 333-128695) on Form S-3 of Smith Micro Software, Inc. of our report dated February 20, 2006 relating to our audit of the financial statements and the financial statement schedule, which appear in this Annual Report on Form 10-K of Smith Micro Software, Inc. for the year ended December 31, 2005.

SINGER, LEWAK, GREENBAUM & GOLDSTEIN, LLP

Los Angeles, California
March 31, 2006

OFFICERS & DIRECTORS		OFFICERS
William W. Smith, Jr. Chairman of the Board, President and CEO Director		**Andrew Schmidt** Vice President, CFO
Thomas G. Campbell Director		**David P. Sperling** Vice President, CTO
William C. Keiper Director		**Bruce T. Quigley** Vice President of Business Development and Investor Relations
Gregory Szabo Director		**Robert Elliot** Vice President of Corporate Marketing
Samuel Gulko Director		**W. Rick Wyand** Vice President of OEM Sales
Ted Hoffman Director		**Jonathan Kahn** Senior Vice President, General Manager Consumer Products
		Chris Lippincott Vice President of Enterprise Sales
		Jeff Costello Vice President of Channel Sales
		Darryl Lovato Vice President of Advance Technology
CORPORATE HEADQUARTERS 51 Columbia Aliso Viejo, CA 92656 (949) 362-5800		**ANNUAL REPORT** Additional copies of this Annual Report are available without charge by contacting the company at: 51 Columbia Aliso Viejo, CA 92656 (949) 362-5800
TRANSFER AGENT AND REGISTRAR Mellon Investor Services LLC 480 Washington Blvd Jersey City, NJ 07310 (800) 356-2017 (800) 356-2017 www.melloninvestor.com **LEGAL COUNSEL** Dorsey & Whitney LLP Irvine, California 92618 **AUDITORS** Singe Lewak Greenbaum & Goldstein LLP Los Angeles, California 90024		**ADDITONAL INFORMATION** Smith Micro maintains an active investor relations program. If you have any questions, or would like additional information concerning the operations or financial statements, please contact either: **Bruce T. Quigley** Vice President of Business Development and Investor Relations Smith Micro Software, Inc. 51 Columbia Aliso Viejo, CA 92656 (949) 362-5800 bquigley@smithmicro.com or **Charles Messman / Todd Kehrli** MKR Group LLC 323 N. San Fernando Burbank, CA 92502 (818) 556-3700 ir@mkr-group.com