



Forward Thinking,  
**Delivered Today.**



**Smith Micro Software**  
**2012 Annual Report**

## FROM THE CEO

Dear Fellow Shareholders,

Our 2012 performance reflects the beginning of an important turning point for Smith Micro. The technology strategy we have been working on for several years is beginning to produce meaningful results in the form of quarter-over-quarter revenue increases. While broadband connectivity has been the linchpin of our portfolio for the past decade, we are now seeing growth from our premium mobile applications and network control solutions that allow wireless operators to generate new revenue streams while efficiently managing their resources. Further, we are leveraging these technologies to help public and private sector organizations take full advantage of the influx of mobile devices among their workforces. Our wireless portfolio, comprised of QuickLink<sup>®</sup>, NetWise<sup>™</sup>, and CommSuite<sup>®</sup> product families, uniquely helps our customers connect, control, and capitalize on the power of the mobile Internet.

Smith Micro has a strong value proposition for a wireless market that is ripe with opportunities. For example, estimates show mobile data traffic growing at a rate of 1.6 Exabytes per month in 2013<sup>1</sup>, posing a major challenge for operators worldwide. Wi-Fi networks are now integral to relieving cellular congestion, and our NetWise traffic management solution is proving to increase Wi-Fi utilization by end-users. However, Wi-Fi offload is only part of the answer. To remain competitive, operators must develop traffic management strategies that ensure a high-quality wireless experience by automatically connecting devices to the best network based on throughput, reliability, roaming costs, and other dynamic conditions. Our NetWise solution is superior to competing products in its ability to manage traffic to ensure the best possible user experience under any conditions.

Monetizing data is an important goal for our wireless operator customers. Considering almost 90 percent of tablets sold in the U.S. last year were Wi-Fi only<sup>2</sup>, wireless operators are largely missing out on the data revenues associated with those devices. Our QuickLink Hotspot solution helps operators by turning the smartphones consumers already have in their hands into personal mobile hotspots that connect Wi-Fi devices to 3G and 4G networks. Although this trend is increasing, a recent survey of smartphone users revealed a number of issues preventing broader adoption of personal hotspots, including cost, usability, and privacy concerns.<sup>3</sup> In addition, many hotspot users do not pay their mobile operator for this feature, but instead use over-the-top applications



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

to access the hotspot feature on their smartphones, representing significant revenue leakage for the operator. QuickLink makes mobile hotspots easier and more secure for consumers, while allowing operators to extend their brand and services to Wi-Fi devices, driving greater data revenues through increased hotspot usage.

Beyond mobile hotspots, 2012 saw the expansion of QuickLink to other new platforms, including Windows 8 devices and silicon chipsets. The use of QuickLink MBIM Drivers by chip vendors allows new USB and embedded modems to work with Windows 8 computers, as well as with prior versions of Windows, eliminating the need for costly, device-specific drivers. It also reduces support costs for operators by eliminating driver conflicts on legacy devices. Embedding connectivity solutions onto chipsets allows operators and device makers to focus on differentiating their products and services to drive the top line, and Smith Micro is contributing on all fronts.

CommSuite is the next generation of our visual voicemail solution, designed to help operators generate new revenue through integrated, rich media communications such as videomail, animated messaging, live video streaming, voice-to-text transcription, and social sharing of messages. With the increasing popularity of social messaging services, operators are projected to lose billions in SMS revenues over the next few years.<sup>4</sup> CommSuite addresses this market shift by revitalizing legacy voicemail systems with the latest in visual messaging technology, while driving rapid adoption of premium apps through flexible “try and buy” deployment options. Even better, CommSuite helps operators manage video messaging traffic through integration with our NetWise solution. This is an important differentiator since video accounted for 51 percent of all mobile traffic at the end of 2012.<sup>5</sup>

On the enterprise side of our business, we were honored to be included in the first annual Aragon Research Globe report for Enterprise Mobile Management (EMM) software.<sup>6</sup> Our EMM solution was recognized for its standards-based approach and scalable platform, which combines device connectivity, user management, and network optimization capabilities. Mobile device management (MDM) has received plenty of attention in the past year, particularly with the growing trend of employees bringing their own devices to work, often called “BYOD” in the media. While there are many vendors providing MDM products, few share our heritage serving Tier One wireless operators and device makers. In fact, we have provided over-the-air device management capabilities for more than 30 million mobile devices globally. By incorporating MDM, connectivity, security, streaming video, and network optimization into our enterprise mobility strategy, we help enterprise customers maximize returns from their mobility investments.

Our Productivity and Graphics group produced several new versions of software in 2012, including Poser® 9, Anime Studio™ 9, Manga Studio™ 5, and the new MotionArtist™

product. Beyond the technical and creative enhancements to these top-shelf graphics products, the team has made significant improvements in online marketing and go-to-market strategy with channel partners to accelerate growth and drive a more profitable business. We are also developing new international channel partners to help increase our market presence in countries such as India, UK, France, Brazil, China, and Korea. Overall, we believe the Productivity and Graphics area of our business will continue to contribute significantly to our top line in 2013.

As we leverage our broad wireless and consumer software portfolios, and enhance our products into comprehensive solutions, we intend to exceed the expectations of our customers and shareholders in 2013. Smith Micro has proven time and time again that we can adapt and recover through the peaks and troughs of each economic and technology cycle. We are optimistic about our ability to prosper and find market opportunities in a rapidly changing mobile technology market, and we appreciate your support and confidence.

Best Regards,



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

<sup>1</sup> [http://www.cisco.com/en/US/solutions/collateral/ns341/ns525/ns537/ns705/ns827/white\\_paper\\_c11-520862.html](http://www.cisco.com/en/US/solutions/collateral/ns341/ns525/ns537/ns705/ns827/white_paper_c11-520862.html)

<sup>2</sup> <http://www.chetansharma.com/USmarketupdateQ22012.htm>

<sup>3</sup> <http://www.smithmicro.com/about/news/nationwide-survey-reveals-increase-in-smartphone-hotspot-adoption.aspx>

<sup>4</sup> <http://ovum.com/2012/09/06/social-messaging-to-cost-telcos-54bn-by-2016/>

<sup>5</sup> [http://www.cisco.com/en/US/solutions/collateral/ns341/ns525/ns537/ns705/ns827/white\\_paper\\_c11-520862.html](http://www.cisco.com/en/US/solutions/collateral/ns341/ns525/ns537/ns705/ns827/white_paper_c11-520862.html)

<sup>6</sup> <http://www.smithmicro.com/about/news/smith-micro-recognized-by-aragon-research-in-enterprise-mobile-management.aspx>

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549  
FORM 10-K**

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

For the fiscal year ended December 31, 2012

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 01-35525**

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

**Delaware**

(State or other jurisdiction of incorporation or organization)

**33-0029027**

(I.R.S. Employer Identification Number)

**51 Columbia, Aliso Viejo, CA**  
(Address of principal executive offices)

**92656**  
(Zip Code)

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

**Common Stock, \$.001 par value**  
(Title of each class)

**The NASDAQ Stock Market LLC  
(NASDAQ Global Market)**  
(Name of each exchange on which registered)

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

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

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 [ ] NO [ X ]

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ 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 [ X ]

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 [ X ]  
Non-accelerated filer [ ] (Do not check if a smaller reporting company) Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES [ ] NO [ X ]

As of June 30, 2012, 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 \$58,524,300 based upon the closing sale price of such stock as reported on the Nasdaq Global 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 February 11, 2013, there were 35,873,247 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement for the 2013 Annual Meeting of Stockholders to be filed under the Securities Exchange Act of 1934 are incorporated by reference in Part III of this report.

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**SMITH MICRO SOFTWARE, INC.**  
**2012 ANNUAL REPORT ON FORM 10-K**  
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## SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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

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

- *changes in demand for our products from our customers and their end-users;*
- *our ability to predict consumer needs, introduce new products, gain broad market acceptance for such products and ramp up manufacturing in a timely manner;*
- *our business and stock price may decline further which could cause an additional impairment of long-lived assets or restructuring charge resulting in a material adverse effect on our financial condition and results of operations;*
- *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 protect our intellectual property and our ability to not infringe on the rights of others;*
- *the availability of third party intellectual property and licenses which may not be on commercially reasonable terms, or not at all;*
- *our ability to successfully execute our business plan and control costs and expenses;*
- *the ongoing uncertainty and volatility in U.S. and worldwide economic conditions may adversely affect our operating results;*
- *security and privacy breaches in our systems may damage client relations and inhibit our ability to grow;*
- *interruptions or delays in the services we provide from our data center hosting facilities could harm our business; and*
- *those additional factors which are listed under the section “IA. Risk Factors” beginning on page 10 of this report.*

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

# PART I

## Item 1. BUSINESS

### General

Smith Micro Software, Inc. provides software and services that simplify, secure and enhance the mobile experience. The Company's portfolio of wireless solutions includes a wide range of client and server applications that manage voice, data, video and connectivity over mobile broadband networks. Our primary customers are the world's leading mobile network operators, mobile device manufacturers and enterprise businesses. In addition to our wireless and mobility software, Smith Micro offers personal productivity and graphics products distributed through a variety of consumer channels worldwide.

The proliferation of mobile broadband technology continues to provide new opportunities for Smith Micro on a global basis. Over the last decade, the Company has developed extensive expertise in embedded software for networked devices (both wireless and wired), and we have leveraged that expertise to solve an unending tide of connectivity and mobile service challenges for our customers. As network operators and businesses struggle to reduce costs and complexity in a market that is characterized by rapid evolution and fragmentation, Smith Micro answers with innovative solutions that increase reliability, security, performance, efficiency, and usability of wireless services over a wide variety of networks and device platforms.

Today, Smith Micro's mission is to help our global customers thrive in a highly complex wireless ecosystem with software solutions that:

1. Simplify mobile connectivity to reduce support costs and increase usability;
2. Optimize network and device resources for maximum performance and efficiency;
3. Enable a safe, productive wireless environment that meets enterprise standards for security, control and regulatory compliance; and
4. Engage and grow high-value relationships with end customers.

With a 30-year history of technology innovation, leadership in industry standards, quality engineering, and extensive commercial deployment experience, Smith Micro has proven its ability to evolve and capitalize on new market opportunities again and again. 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, Aliso Viejo, California 92656. Our telephone number is (949) 362-5800. Our website address is [www.smithmicro.com](http://www.smithmicro.com). We make our SEC filings 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.

### Business Segments

Our operations are organized into two business segments: Wireless and Productivity & Graphics. We do not separately allocate operating expenses, nor do we allocate specific assets to these groups. Therefore, segment information reported includes only revenues and cost of revenues. See Note 7 of Notes to Consolidated Financial Statements for financial information related to our business segments and geographical information.



## Wireless

Rapid advancements in wireless technology, including higher speed networks, intelligent connected devices and an abundance of digital content and mobile applications, are fueling the mobile broadband market. The demand for pervasive connectivity is driven by an insatiable consumer desire to access information and digital entertainment - anytime, anywhere - from smartphones, tablets, laptop computers, e-readers, gaming devices and more. While the benefits and opportunities associated with increased mobility are plenty, so are the challenges of this highly dynamic environment:

- Wireless data services are being adopted at such a fast pace that global wireless networks cannot support them without significant investments to increase capacity and performance.
- Operators are being marginalized by over-the-top applications and social networks as they struggle to supplement declining voice and messaging revenues with new data services.
- Device makers face increasing pressure to differentiate their platforms and accelerate time to market while burdened by network certification requirements that differ for each wireless carrier.
- Enterprises are challenged to mobilize their work forces and provide wireless access to business-critical information without sufficient tools to manage security, performance and costs.
- End users must adapt to a variety of mobile platforms, a deluge of disparate mobile apps, and unreliable connection methods while learning to understand and manage costs of consuming data.

To address these challenges, Smith Micro has developed a robust wireless software portfolio comprised of three product families that help our customers *connect*, *control* and *capitalize* on the power of the mobile internet:

QuickLink® – software that helps users and devices *connect* to the mobile internet, easily and reliably while managing their data usage.

NetWise™ – policy-based *control* solutions for intelligently managing data traffic and devices.

CommSuite® – premium voice, video and messaging applications to *capitalize* on the proliferation of mobile devices and broadband data services.

Our flagship QuickLink connectivity solutions have been shipped on more than 100 million devices worldwide. This patented technology allows mobile users to easily connect a tablet, laptop or other wireless devices to cellular or Wi-Fi networks. Many of the world's largest wireless service providers, including AT&T, Bell Canada, Bouygues, Cablevision, Orange, Sprint, T-Mobile USA, Verizon Wireless, and Vodafone, use QuickLink to provide a convenient and secure mobile connection for subscribers using their wireless data services. QuickLink helps operators reduce support costs by making connectivity consistent across device types and enabling automated diagnostics for subscriber self-care. It also provides a channel to promote new operator services that can increase average revenue per user (“ARPU”) and customer loyalty. QuickLink is also available for enterprises with mobile workforces, and the public sector, providing enhanced security and configurability across carrier, public and private networks.

NetWise traffic and device management solutions help wireless operators alleviate network congestion resulting from the explosion of mobile data services. Using NetWise, subscribers can be automatically connected to – and transparently moved between – 3G, 4G and Wi-Fi networks to ensure the best possible user experience, providing potentially significant savings in capital outlays for operators. With its unique intelligent client and policy-based server design, NetWise gives operators visibility and control over data traffic by using the power of the device to manage when and how network services are accessed. NetWise supplements existing network servers to provide end-to-end authentication and seamless network transitions, adding advanced policy controls for least-cost roaming, Quality of Service (“QoS”)

management, disabling unauthorized or chatty applications, and more. NetWise solutions also facilitate Wi-Fi discoverability, provide detailed device analytics, and enable management of mobile devices over the air.

With CommSuite, Smith Micro enhances mobile communications through voice, video and messaging services like Push-to-Talk, Visual Voicemail, Voice-to-Text transcription, Video mail and more, all within a single client application. CommSuite allows operators to drive new revenues from existing voice and messaging infrastructure by simplifying usability and adding innovative features, such as talking avatars, live videocasting, and customizable user interfaces, to compete with the latest over-the-top applications. CommSuite solutions can be offered in various bundles for different market segments, with flexible billing integration that supports popular “freemium” and ad-based business models. For enterprises, CommSuite provides secure, adaptive video streaming for a variety of uses, including mobile conferencing, multi-screen viewing, mobile delivery of rights-managed content (like on-demand movies), public safety surveillance video, and more.

Beyond the advanced features within each product family, the expertise to integrate technologies across the entire portfolio is an advantage that Smith Micro uniquely brings to its customers. For example, the ability to enhance mobile communications with CommSuite Video mail can be combined with NetWise traffic management capabilities to ensure that the resulting video traffic is restricted to Wi-Fi or 4G networks. Using technology and experience acquired over 30 years, Smith Micro continues to deliver new solutions to meet new market challenges.

## **Productivity & Graphics**

The Productivity & Graphics Group focuses on developing a variety of software for the consumer, prosumer, and professional markets. Our solutions span compression, graphics and utilities. This group also republishes and markets third party software titles that complement our existing line of products. All of these products are available through direct sales on the Smith Micro websites (smithmicro.com, mysmithmicro.com and contentparadise.com), on affiliate websites, direct through customer service order desks, on-line resellers and through traditional retail outlets.

The group’s primary product offering is its line of graphic titles, in particular Poser®, Anime Studio®, Manga Studio™ and MotionArtist™. These products are aimed at digital artists of all skill levels helping them to produce professional level animations, comics, and other 2D and 3D art. Poser is the industry leading tool for 3D human figure design and animation. Anime Studio is used by both hobbyists and professional artists working for high-end animation studios like Disney, and Manga Studio is at the top of the market for comic illustration software, used by famous graphic novelists such as Dave Gibbons, the author of the Watchmen. The group is focused on pursuing adjacent markets to these graphic arts, as well as new platforms for the existing titles, such as iOS.

The secondary product line is StuffIt®, driven by its patented and patent-pending image compression, with a focus on our innovative “lossless” JPEG compression technology. StuffIt provides superior lossless compression, encryption and archiving. We have enhanced this industry-leading product’s feature set with new, online file transfer capabilities.

## Products and Services

Our primary products consist of the following:

Product Groups	Products	Description	
Wireless	QuickLink® Mobile	Connection management application to control, customize and automate wireless connections from PCs and Macs to WWAN and WLAN/Wi-Fi networks	
	QuickLink® Mobility	Mobile VPN and connection manager targeted to enterprises with mobile workforces and the public sector	
	QuickLink® Hotspot QuickLink® Zero	An application that optimizes the user-experience with billing integration, automated diagnostics, and usage metering for mobile hotspot features on Smartphones and mobile broadband devices	
	QuickLink® MiTile	Connection manager for Microsoft Windows 8 devices	
	QuickLink® MBIM Drivers	Customizable drivers that support the Mobile Broadband Interface Model (MBIM) standard for connecting USB devices to a variety of operating systems	
	NetWise™ Director	Intelligent traffic management for data offload and seamless, secure network transitions between 3G/4G/Wi-Fi	
	NetWise™ Passport	Application-based controls over wireless network access to protect against unauthorized or chatty apps	
	NetWise™ SmartSpot	Wi-Fi discoverability, promotion and automated authentication	
	NetWise™ DM Suite	Management platform for mobile device provisioning and configuration	
	CommSuite® PTT	A push-to-talk data service that uses a mobile Internet connection to send and receive “walkie-talkie” style calls	
	CommSuite® VVM	Visual Voicemail (VVM) delivered directly to a mobile phone app and managed like email	
	CommSuite® VTT	Voice-to-Text (VTT) transcription of voicemail and voice SMS messages	
	CommSuite® VIDIO	Adaptive streaming of video content to support mobile viewing across laptops, tablets, phones, TVs, and more.	
CommSuite® VIDIOcast and VIDIOmail	Delivery of live or pre-recorded video messages captured on mobile devices and available via web link with no client application required		
Productivity & Graphics	Poser®	A solution for creating 3D character art and animations	
	Anime Studio®	An animation tool for professionals and digital artists	
	Manga Studio™	A solution for creating manga and comic art	
	MotionArtist™	A solution for creating interactive presentations	
	StuffIt Deluxe®	Patented, lossless compression solution for documents and media	

## Marketing and Sales Strategy

Because of our broad product portfolio and deep device integration experience, we are able to leverage technologies across a wide range of platforms and operating systems to quickly bring to market innovative solutions that meet the evolving needs of our customers. We continue to offer flexible, performance-based business models that align with our customers’ needs to create new revenue opportunities and differentiate their products and services among their competitors.

Our sales strategy is as follows:

*Leverage Carrier and OEM Relationships.* We continue to capitalize on our strong relationships with the world's leading wireless carriers and mobile device manufacturers. Our carrier customers serve as our primary distribution channel, providing access to hundreds of millions of end-users around the world, and also providing market feedback for future product offerings.

*Focus on High-Growth Markets.* We continue to focus on wireless connectivity and communications solutions taking advantage of enhanced 4G networks developed by wireless carriers and an increasing availability of rich media and multi-media enabled Smartphones, Tablets, eReaders and other emerging cellular and Wi-Fi devices.

*Expand our Customer Base.* In addition to introducing new products to current customers, we are growing our domestic and international business through sales to new carriers and device manufacturers, as well as increased penetration of the enterprise market, with particular focus on hospitality and public safety vertical markets.

*Selectively Pursue Partnerships and Acquisitions of Complementary Products and Services.* We continue to pursue partnerships and acquisition opportunities that will enhance our portfolio, help us enter complementary markets, and extend our geographic reach. We will leverage partnerships with technology providers and systems integrators to further our penetration into new markets and deliver more comprehensive solutions to our customers.

Revenues to two customers (Sprint and Verizon Wireless) and their respective affiliates in the Wireless business segment accounted for 40.7% and 20.5%, respectively, of the Company's total revenues for the fiscal year 2012. In 2011, our three largest customers (Sprint, Verizon Wireless and AT&T) accounted for 24.8%, 18.4% and 11.7%, respectively, of our total revenues. In 2010, our three largest customers (Verizon Wireless, Sprint and AT&T) accounted for 40.1%, 13.9% and 12.3%, respectively, of our total revenues. 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 customers or decisions by a significant customer to substantially reduce purchases could have a material adverse effect on our business.

## **Customer Service and Technical Support**

We provide technical support and customer service through our online knowledge base, via email, live chat and by telephone. OEM customers generally provide their own primary customer support functions and rely on us for support to 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 product 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 \$24.8 million, \$41.7 million, and \$42.8 million for the years ended December 31, 2012, 2011 and 2010, respectively.

## **Manufacturing**

Although we primarily deliver our software via electronic downloads, we do deliver our software in several other forms. We offer a package or kit that may include CD-ROM(s) and certain other documentation or marketing material. We also permit selected OEM customers to duplicate our products on their own CD-ROM's, USB devices, or embedded devices, and pay a royalty based on usage. Some OEM business requires that we provide a CD, which includes a soft copy of a user guide. 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 their 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. Our manufacturing is subcontracted to outside vendors and includes the replication of CD-ROM's and the printing of documentation materials. Assembly of the final package is completed by our Aliso Viejo, California facility.

## **Competition**

The markets in which we operate are highly competitive and subject to rapid changes in technology. These conditions create new opportunities for Smith Micro, as well as for our historical connection management competitors, 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 new customer contracts, as well as in our efforts to acquire technology and qualified personnel.

We believe that the principal competitive factors affecting the mobile software market include domain expertise, product features, usability, 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.

Many existing and potential carrier and OEM customers have the resources to develop products that compete directly with our products. These customers may discontinue the purchase of our products. Our future performance is substantially dependent upon the extent to which existing carrier and OEM customers elect to purchase software from us rather than design and develop their own software.

## **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 and intellectual property, we rely on a combination of trade secrets, nondisclosure agreements, patents, copyright and trademark law that may afford only limited protection. As of December 31, 2012, we owned 64 issued U.S. patents and have 52 U.S. patent applications that are currently pending. These patents are intended to provide generalized protection of our intellectual property technology base and we will continue to apply for various patents and trademarks in the future as we deem necessary to protect our intellectual property technology base.

We seek to avoid unauthorized use and disclosure of our proprietary 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 deterrent 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 any adverse claim against us relating to software or intellectual property 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 currently use to protect and enforce all of our proprietary rights and intellectual property rights may not be adequate. Moreover, our competitors may independently develop competitive 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 such third party technologies become subject to claims directed to or against the third party technologies used by us, 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, 2012, we had a total of 337 employees within the following departments: 202 in engineering, 74 in sales and marketing, 33 in operations and customer support and 28 in management and administration. We are not subject to any collective bargaining agreement and we believe that our relationships with our employees are good.

## **Item 1A. 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 revenues currently depend on a small number of products and customers, so our revenue and operating results are vulnerable to shifts in demand and may continue to decline.***

A substantial majority of our revenue is derived from sales of our wireless software products. Revenues from sales of our core connection management product have recently declined and may continue to decline in future quarters due to shifts in technology, particularly the inclusion of connectivity in the operating system of new devices and decline in sales of USB hardware by wireless carriers. We have developed new products which address these shifts in technology, but revenues from these products have not been able to offset the decreases in our core connection management product revenues. There can be no guarantee that our revenues will stabilize or increase in future years.

In addition, our strategy is to continue to introduce and market new products, but these efforts are not likely to reduce the extent to which our revenues are dependent on a small number of products. Rapid shifts in the markets for these products and consumer habits, changes in demand by end-users and changes in underlying technology could cause material and rapid changes in our revenues and profitability. Factors which could affect demand for our products include the rate of adoption of the 4G networking standard by wireless carriers and handset manufacturers, and changes in consumer demand for PC networking due to

the adoption of Smartphones and Tablet computing. If our products fail to remain current with and useful to new and emerging markets, our business, financial condition and results of operations would be materially and adversely affected.

We also derive a significant portion of our revenues from a few vertical markets, such as wireless carriers and handset manufacturers. In order to sustain and grow our business, we must continue to sell our software products into these vertical markets. Shifts in the dynamics of these vertical markets, such as new product introductions by our competitors, could materially harm our results of operations, financial condition and prospects. To increase our sales outside our core vertical markets, for example to large enterprises, requires us to devote time and resources to hire and train sales employees familiar with those industries. Even if we are successful in hiring and training sales teams, customers in other vertical markets may not need or sufficiently value our current products or new product introductions.

Because we sell primarily to large carriers and OEMs, there are a limited number of actual and potential customers for our products, resulting in customer concentration for sales of our products and services. For the year ended December 31, 2012, Sprint and Verizon Wireless comprised of 40.7 and 20.5%, of our total revenues, respectively. Because of our customer concentration, our largest customers may have significant pricing power over us. Furthermore, a substantial decrease in sales to any of our largest customers could materially affect our revenues and profitability. Additionally, these customers are not the end-users of our products. If any of these customers' efforts to market their products which incorporate our software are unsuccessful in the marketplace, our revenues and profitability could be adversely affected.

In addition, in October 2012, Softbank agreed to acquire an approximately 70% ownership position in Sprint Nextel, and the parent company of T-Mobile USA agreed to combine T-Mobile and MetroPCS Communications. These transactions are each subject to regulatory review and approval. If approved, these transactions could further intensify the competitive pressures that we face. Furthermore, the proposed transactions could cause delays or cancellations of planned purchases of our products and services by these carriers, particularly if there are proposed changes or uncertainties in the future management, product offerings and technical specifications of these carriers.

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

Our quarterly revenues 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 gain or loss of a key customer;
- the size and timing of orders from and shipments to our major customers;
- the size and timing of any product return requests;
- our ability to maintain or increase gross margins;
- variations in our sales channels or the mix of our product sales;
- our ability to anticipate market needs and to identify, develop, complete, introduce, market and produce new products and technologies in a timely manner to address those needs;
- the availability and pricing of competing products and technologies and the resulting effect on sales and pricing of our products;
- acquisitions;
- the effect of new and emerging technologies;
- the timing of acceptance of new mobile services by users of our customers' services;
- deferrals of orders by our customers in anticipation of new products, applications, product

- enhancements or operating systems; and
- general economic and market conditions.

We have difficulty predicting the volume and timing of orders. In any given quarter, our sales have involved, and we expect will continue to involve, large financial commitments from a relatively small number of customers. As a result, the cancellation or deferral of even a small number of orders would reduce our revenues, which would adversely affect our quarterly financial performance. Also, we have often booked a large amount of our sales in the last month of the quarter and often in the last week of that month. Accordingly, delays in the closing of sales near the end of a quarter could cause quarterly revenues to fall substantially short of anticipated levels. Significant sales may also occur earlier than expected, which could cause operating results for later quarters to compare unfavorably with operating results from earlier quarters.

Future orders may come from new customers, or from existing customers for new products. The sales cycles may be greater than what we have experienced in the past, increasing the difficulty to predict quarterly revenues.

Because we sell primarily to large carriers and OEM customers, we have no direct relationship with most end-users of our products. This indirect relationship delays feedback and blurs signals of change in the quick-to-evolve wireless ecosystem, and is one of the reasons we have difficulty predicting demand.

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.

***We may have further impairments of long-lived assets if our business does not improve and our stock price declines which could cause a material adverse effect on our financial condition and results of operations.***

The Company assesses potential impairment to its long-lived assets as required by FASB ASC Topic No. 360, Property, Plant, and Equipment, when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized when the carrying amount of the long-lived assets exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Any required impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value and is recorded as a reduction in the carrying value of the related asset and a charge to operating results. For the year ended December 31, 2011, we recorded a charge for impairment of long-lived assets of \$18.7 million (\$13.4 million on intangible assets and \$5.3 million on fixed assets) due, in part, to continued declines in our revenues and profitability and our continued depressed stock price. In future years, we may be required to take further charges for impairment of fixed assets, which could have a material adverse effect on our financial condition and results of operations.

***Competition within our target markets is intense and includes numerous established competitors and new entrants, which could negatively affect our revenues and results of operations.***

We operate in markets that are extremely competitive and subject to rapid changes in technology. A number of established software and hardware companies, such as Microsoft Corporation, Google Inc. and Apple Inc. pose a significant competitive threat to us because their handset operating systems and phones may include some capabilities now provided by certain of our OEM and retail software products. If handset manufacturers and carriers are satisfied relying on the capabilities of systems using Windows, Android or iPhone OS, or other hardware or operating systems, sales of our products are likely to decline. In addition,



because there are low barriers to entry into the software markets in which we participate and may participate in the future, we expect significant competition to continue from both established and emerging software companies in the future, both domestic and international. In fact, our growth opportunities in new product markets could be limited to the extent established and emerging software companies enter or have entered those markets. Furthermore, our existing and potential OEM customers may acquire or develop products that compete directly with our products.

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 than we can to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products. Announcements of competing products by competitors could result in the cancellation of orders by customers in anticipation of the introduction of such new products. In addition, some of our competitors are currently making 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.

***Technology and customer needs change rapidly in our market, which could render our products obsolete and negatively affect our business, financial condition and results of operations.***

Our success depends 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 target markets' changing demands, keep up with evolving industry standards, including changes in the Microsoft, Google and Apple 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 and called for by evolving wireless networking technologies. If our target markets do not develop as we anticipate, our products do not gain widespread acceptance in these markets, or we are unable to develop new versions of our software products that can operate on future wireless networks and PC and mobile device operating systems and interoperate with other popular applications, our business, financial condition and results of operations could be materially and adversely affected.

***We are entering new, emerging markets in which we have limited experience; if these markets do not develop or we are unable to otherwise succeed in them, our revenues will suffer and the price of our common stock will likely decline.***

Our recent and planned product introductions to support new higher speed networking and 4G technologies such as HSPA+, LTE and WiMAX network protocols have allowed us to enter new markets. A viable market for these products may not develop or be sustainable, and we may face intense competition in these markets. In addition, our success in these markets depends on our carrier customers' ability to successfully introduce new mobile services enabled by our products and our ability to broaden our carrier customer base, which we believe will be difficult and time-consuming. If the expected benefits from entering new markets do not materialize, our revenues will suffer and the price of our common stock would likely decline. In addition, to the extent we enter new markets through acquisitions of companies or technologies, our financial condition could be harmed or our stockholders could suffer dilution without a corresponding benefit to our company if we do not realize expected benefits of entering such new markets.

***If the adoption of and investments in new technologies and services grows more slowly than anticipated in our product planning and development, our operating results, financial condition and prospects may be negatively affected.***

If the adoption of and investments in new networking and 4G technologies and services does not grow or grows more slowly than anticipated, we will not obtain the anticipated returns from our planning and development investments. For example, our Enterprise products allow our customers to update mobile devices from a home office and incorporate technology that provides a mechanism to allow for efficient firmware updates for mobile devices. In addition, we have introduced new high-speed networking and 4G products, but the pace of the market introduction of such technologies is uncertain. Future sales and any future profits from these and related products are substantially dependent upon the acceptance and use of these new technologies, and on the continued adoption and use of mobile data services by end-users.

Many of our customers and other communications service providers have made and continue to make major investments in next generation networks that are intended to support more complex applications. If communications service providers delay their deployment of networks or fail to deploy such networks successfully, demand for our products could decline, which would adversely affect our revenues. Also, to the extent we devote substantial resources and incur significant expenses to enable our products to be interoperable with new networks that have failed or have been delayed or not deployed, our operating results, financial condition and prospects may be negatively affected.

***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 products. 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, 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.

***We rely directly and indirectly on third-party intellectual property and licenses, which may not be available on commercially reasonable terms or at all.***

Many of the Company's products and services include third-party intellectual property, which requires licenses from those third parties directly to us or to unrelated companies which provide us with sublicenses and/or execution of services for the operation of our business. These products and services include our wireless suite of products as well as our productivity and graphics products. The Company has historically been able to obtain such licenses on reasonable terms. There is however no assurance that in the future the necessary licenses could be obtained on acceptable terms or at all. If the Company or our third party service providers are unable to obtain or renew critical licenses on reasonable terms, we may be forced to terminate or curtail our products and services which rely on such intellectual property and our financial condition and operating results may be materially adversely affected.

***If we fail to continue to establish and maintain strategic relationships with mobile device manufacturers, wireless carriers and network infrastructure manufacturers, market acceptance of our products and our profitability may suffer.***

Most of our strategic relationships with mobile device manufacturers are not subject to written contract, but rather are in the form of informal working relationships. We believe these relationships are valuable to our

success. In particular, these relationships provide us with insights into product development and emerging technologies, which allows us to keep abreast of, or anticipate, market trends and helps us serve our current and prospective customers. Because these relationships are not typically governed by written agreements, there is no obligation for many of our partners to continue working with us. If we are unable to maintain our existing strategic relationships with mobile device manufacturers or if we fail to enter into additional strategic relationships or the parties with whom we have strategic relationships favor one of our competitors, our ability to provide products that meet our current and prospective customers' needs could be compromised and our reputation and future revenue prospects could suffer. For example, if our software does not function well with a popular mobile device because we have not maintained a relationship with its manufacturer, carriers seeking to provide that device to their respective customers could choose a competitor's software over ours or develop their own. Even if we succeed in establishing these relationships, they may not result in additional customers or revenues.

***Our growth depends in part on our customers' ability and willingness to promote services and attract and retain new customers or achieve other goals outside of our control.***

We sell our products for use on handheld devices primarily through our carrier customers. Losing the support of these customers may limit our ability to compete in existing and potential markets and could negatively affect our revenues. In addition, the success of these customers and their ability and willingness to market services supported by our products is critical to our future success. Our ability to generate revenues from sales of our software is also constrained by our carrier customers' ability to attract and retain customers. We have no input into or influence upon their marketing efforts and sales and customer retention activities. If our large carrier customers fail to maintain or grow demand for their services, revenues or revenue growth from our products designed for use on mobile devices will decline and our results of operations will suffer.

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

Our operations and performance depend significantly on economic conditions in the United States and worldwide. The U.S. and global economic outlook remain uncertain, primarily due to the European sovereign debt crisis, weakness in U.S. discretionary consumer spending and uncertainties regarding mandated tax increases and government spending cuts (referred to as the "fiscal cliff"), the slowing economy in China and volatile oil prices. A general weakening of, and related decline of confidence in, the U.S. and global economies or the curtailment in government or corporate spending could make it difficult for current or potential wireless carrier and OEM customers and their end users to accurately forecast and plan future business activities and capital expenditures, which could cause them to slow spending on our products and services. These and other economic factors could adversely affect demand for our products and services and our financial condition and operating results, and may require us to record additional charges related to restructuring costs and/or the impairment of long-lived assets.

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

We have historically made targeted acquisitions of smaller companies with important technology and expect to continue to do so in the future. As part of any acquisition, 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 not be able 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. Our financial condition could be harmed to the extent we incur substantial debt or use significant amounts of

our cash resources in 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, write offs, amortization expenses, and charges related to acquired intangible assets. 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.

***Our operating income or loss may continue to change due to shifts in our sales mix and increased spending on our research and development.***

Our operating income or loss can change quarter to quarter and year to year due to a change in our sales mix and the timing of our continued investments in research and development and infrastructure. We continue to invest in research and development which is the lifeline of our technology portfolio. The timing of these additional expenses can vary significantly quarter to quarter and even from year to year.

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

Our software products are complex and may contain undetected defects. In the past, we have discovered software defects in certain of our products and have experienced delayed or lost revenues during the period it took to correct these problems. Although we and our OEM customers test our products, it is possible that errors may be found or occur in our new or existing products after we have commenced commercial shipment of those products. Defects, whether actual or perceived, could result in adverse publicity, loss of revenues, product returns, a delay in market acceptance of our products, loss of competitive position or claims against us by customers. Any such problems could be costly to remedy and could cause interruptions, delays, or cessation of our product sales, which could cause us to lose existing or prospective customers and could negatively affect our results of operations. In addition, some of our software contains open source components that are licensed under the GNU General Public License and similar open source licenses. These components may contain undetected defects or incompatibilities, may cause us to lose control over the development of portions of our software code, and may expose us to claims of infringement if these components are, or incorporate, infringing materials, the licenses are not enforceable or are modified to become incompatible with other open source licenses, or exposure to misappropriation claims if these components include unauthorized materials from a third party.

***Regulations affecting our customers and us and future regulations, to which they or we may become subject to, may harm our business.***

Certain of our customers in the communications industry are subject to regulation by the Federal Communications Commission, which could have an indirect effect on our business. In addition, the United States telecommunications industry has been subject to continuing deregulation since 1984. We cannot predict when, or upon what terms and conditions, further regulation or deregulation might occur or the effect regulation or deregulation may have on demand for our products from customers in the communications industry. Demand for our products may be indirectly affected by regulations imposed upon potential users of those products, which may increase our costs and expenses.

***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 secrets, nondisclosure agreements, patents, and copyright and trademark law. We currently own U.S. trademark registrations for certain of our trademarks and U.S. 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 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. Additionally, our customer agreements require that we indemnify our customers for infringement claims made by third parties involving our intellectual property embedded in their 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.

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

We believe that the cash and cash equivalents and short-term investments on hand and the cash we expect to generate from operations will be sufficient to meet our capital needs for at least the next twelve months. However, it is possible that we may need or choose to obtain additional financing to fund our activities in the future. We could raise these funds by selling more stock to the public or to selected investors, 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 rights to certain technologies or potential markets.

We have on file with the SEC a shelf Form S-3 to sell from time to time up to 4,000,000 shares of our common stock in one or more offerings in amounts, at prices and on the terms that we will determine at the time of offering. In addition, we have on file with the SEC a shelf Form S-4 to sell from time to time up to 1,000,000 shares of our common stock in connection with our future acquisitions of other businesses, assets or securities. If we raise additional funds by issuing additional equity or convertible debt securities (whether in a public offering or private placement), 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;
- our ability to meet our headcount hiring commitment to the state of Pennsylvania;
- technological advances;

- our competitors' response to our products; and
- our relationships with suppliers and customers.

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

***We risk being delisted from NASDAQ if our stock trades below \$1.00 per share.***

Our stock is currently trading above \$1.00 per share. However, if our stock price were to drop below \$1.00 per share and remain below \$1.00 per share for an extended period of time, we would be in violation of the continued listing requirements of the NASDAQ Global Market ("NASDAQ") and would risk delisting of our shares from NASDAQ. If our common stock were delisted from NASDAQ, this could have a number of negative consequences, including reduced liquidity of our common stock, the loss of federal preemption of state securities laws, potential loss of confidence by suppliers, customers and employees, loss of additional analyst coverage and institutional investor interest, and more difficulty in raising capital on favorable terms, if at all.

If our market capitalization remains low for an extended period of time, additional investment analysts who follow our stock may drop their coverage of the Company, which could reduce interest in our stock by institutional investors and reduce liquidity of our shares.

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

In recent years, our revenues derived from sales to customers outside the U.S. have not been material. Our revenues derived from such sales can vary 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 any 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;
- fluctuations in currency exchange rates and any imposition of currency exchange controls; 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.

*Security and privacy breaches in our systems may damage client relations and inhibit our growth.*

The uninterrupted operation of our hosted solutions and the confidentiality and security of third-party information is critical to our business. Any failures in our security and privacy measures could have a material adverse effect on our financial position and results of operations. If we are unable to protect, or our clients perceive that we are unable to protect, the security and privacy of our electronic information, our growth could be materially adversely affected. A security or privacy breach may:

- Cause our clients to lose confidence in our solutions;
- Harm our reputation;
- Expose us to liability; and
- Increase our expense from potential remediation costs.

While we believe we use proven applications designed for data security and integrity to process electronic transactions, there can be no assurance that our use of these applications will be sufficient to address changing market conditions or the security and privacy concerns of existing and potential clients.

*Interruptions or delays in service from data center hosting facilities could impair the delivery of our service and harm our business.*

We currently serve our customers from data center hosting facilities. Any damage to, or failure of, our systems generally could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their on-demand services and adversely affect our renewal rates and our ability to attract new customers.

## **Item 1B. UNRESOLVED STAFF COMMENTS**

None.

## **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 52,700 square feet of space pursuant to leases that expire on May 31, 2016 and January 31, 2022. We lease approximately 55,600 square feet in Pittsburgh, Pennsylvania under a lease that expires December 31, 2021. We lease approximately 16,000 square feet in Sunnyvale, California under a lease that expires February 28, 2015. We lease approximately 15,300 square feet in Watsonville, California under a lease that expires September 30, 2018.

Internationally, we lease space in Belgrade, Serbia that expires December 30, 2016 and Vancouver, Canada that expires March 31, 2014.

## **Item 3. LEGAL PROCEEDINGS**

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

resolution could materially affect the Company's future consolidated results of operations, cash flows or financial position in a particular period.

#### **Item 4. MINE SAFETY DISCLOSURES**

Not Applicable.



## PART II

### Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### Market Information

Our common stock is traded on the NASDAQ Global 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.

	<u>High</u>	<u>Low</u>
YEAR ENDED DECEMBER 31, 2012:		
First Quarter	\$2.87	\$1.14
Second Quarter	2.37	1.46
Third Quarter	2.16	1.49
Fourth Quarter	1.89	1.10
YEAR ENDED DECEMBER 31, 2011:		
First Quarter	\$17.03	\$7.90
Second Quarter	9.49	3.94
Third Quarter	4.22	1.45
Fourth Quarter	1.73	0.96

On February 11, 2013, the closing sale price for our common stock as reported by NASDAQ was \$1.70.

For information regarding Securities Authorized for Issuance under Equity Compensation Plans, please refer to Item 12.

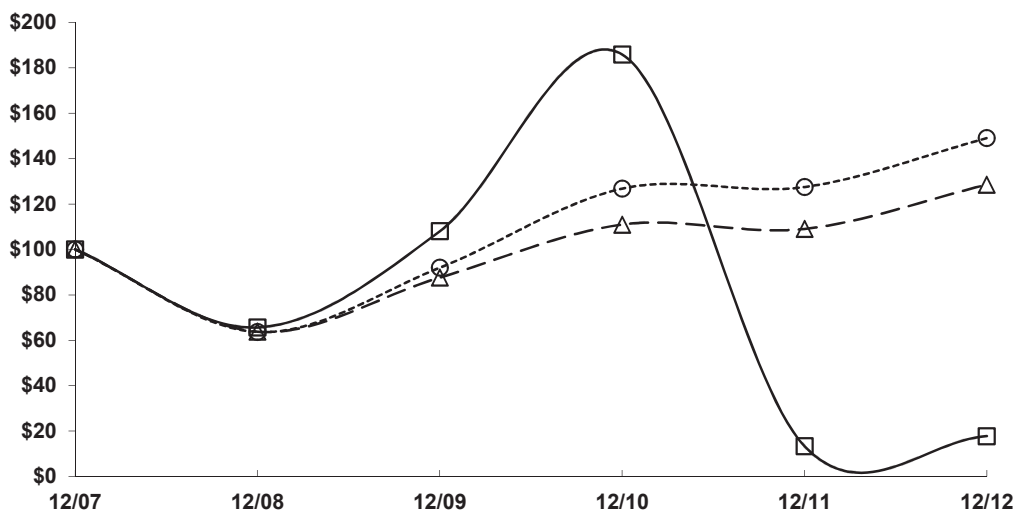
#### Stock Performance Graph

The following graph and information compares the cumulative total stockholder return on our common stock against the cumulative total return of the S&P Midcap 400 Index and the S&P Midcap Applications Software Index (Peer Group) for the same period.

The graph covers the period from December 31, 2007 through December 31, 2012. The graph assumes that \$100 was invested in our common stock on December 31, 2007, and in each index, and that all dividends were reinvested. No cash dividends have been declared on our common stock. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.

## COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\*

Among Smith Micro Software, Inc., the S&P Midcap 400 Index  
and S&P MidCap Application Software



—■— Smith Micro Software, Inc.    -▲- S&P Midcap 400    ---○--- S&P MidCap Application Software

\*\$100 invested on 12/31/07 in stock or index, including reinvestment of dividends.  
Fiscal year ending December 31.

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	12/07	12/08	12/09	12/10	12/11	12/12
Smith Micro Software, Inc.	100.00	65.64	108.03	185.83	13.34	17.71
S&P Midcap 400	100.00	63.77	87.61	110.94	109.02	128.51
S&P MidCap Application Software	100.00	63.66	91.94	126.77	127.46	149.02

## Holders

As of February 11, 2013, there were approximately 169 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

None.

## Purchases of Equity Securities by the Company

The table set forth below shows all purchases of securities by us during the fiscal year 2012:

<b>ISSUER PURCHASES OF EQUITY SECURITIES</b>				
<b>Period</b>	<b>Total Number of Shares (or Units) Purchased</b>	<b>Average Price Paid per Share (or Unit)</b>	<b>Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs</b>
Jan. 1-31, 2012	-	-	-	-
Feb. 1-29, 2012	4,812	\$1.28	-	-
Mar. 1-31, 2012	-	\$2.61	125,000	4,875,000
Apr. 1-30, 2012	-	-	-	4,875,000
May 1-31, 2012	6,857	\$1.71	196,500	4,678,500
Jun. 1-30, 2012	-	\$1.68	53,500	4,625,000
July 1-31, 2012	-	-	-	4,625,000
Aug. 1-31, 2012	6,046	\$1.76	-	4,625,000
Sep. 1-30, 2012	326	\$1.65	-	4,625,000
Oct. 1-31, 2012				4,625,000
Nov. 1-30, 2012				4,625,000
Dec. 1-31, 2012	5,280	\$1.65		4,625,000
Total	23,321(a)		375,000	4,625,000(b)

The above table includes:

(a) Acquisition of stock by the Company as payment of withholding taxes in connection with the vesting of restricted stock awards, in an aggregate amount of 23,321 shares during the periods set forth in the table. All of the shares were cancelled when they were acquired.

(b) Repurchases of stock under a program announced on November 2, 2011 authorizing the repurchase by the Company of up to 5,000,000 shares over a period of up to two years. Under this program, stock repurchases may be made from time to time and the actual amount expended will depend on a variety of factors including market conditions, regulatory and legal requirements, corporate cash generation and other factors. The stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of Rule 10b5-1 trading plans. The program does not obligate the Company to repurchase any particular amount of common stock during any period and the program may be modified or suspended at any time at the Company's discretion.

## 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 comprehensive income data for the years ended December 31, 2012, 2011 and 2010, and the consolidated balance sheet data at December 31, 2012 and 2011, have been derived from audited consolidated financial statements included elsewhere in this Annual Report. The consolidated statement of comprehensive income data presented below for the years ended December 31, 2009 and 2008, and the consolidated balance sheet data at December 31, 2010, 2009 and 2008 are derived from audited consolidated financial statements that are not included in this Annual Report.

	Year Ended December 31,				
	2012	2011	2010	2009	2008
<b>Consolidated Statement of Comprehensive Income Data (in thousands, except per share data):</b>					
Revenues	\$ 43,329	\$ 57,767	\$ 130,501	\$ 107,279	\$ 98,424
Cost of revenues	8,448	13,761	15,507	15,486	20,108
Gross profit	34,881	44,006	114,994	91,793	78,316
Operating expenses:					
Selling and marketing	16,666	26,594	29,708	24,999	24,814
Research and development	24,767	41,711	42,759	36,530	30,811
General and administrative	20,211	25,279	24,146	19,155	19,990
Restructuring expenses	238	3,184	-	-	-
Goodwill and long-lived asset impairment	-	112,904	-	-	-
Total operating expenses	61,882	209,672	96,613	80,684	75,615
Operating income (loss)	(27,001)	(165,666)	18,381	11,109	2,701
Non-operating income:					
Change in fair value of contingent liability	1,210	-	-	-	-
Interest and other income, net	94	131	130	381	739
Income (loss) before provision for income taxes	(25,697)	(165,535)	18,511	11,490	3,440
Provision for income tax expense (benefit)	(234)	(5,929)	6,165	6,738	4,172
Net income (loss)	(25,463)	(159,606)	12,346	4,752	(732)
Other comprehensive income (loss), before tax:					
Unrealized holding gains (losses) on available-for-sale securities	33	(24)	(14)	(118)	103
Income tax expense (benefit) related to items of other comprehensive income (expense)	6	1	(6)	(47)	34
Other comprehensive income (expense), net of tax	27	(25)	(8)	(71)	69
Comprehensive income (loss)	\$ (25,436)	\$ (159,631)	\$ 12,338	\$ 4,681	\$ (663)
Net income (loss) per share:					
Basic	\$ (0.71)	\$ (4.48)	\$ 0.36	\$ 0.15	\$ (0.02)
Diluted	\$ (0.71)	\$ (4.48)	\$ 0.36	\$ 0.14	\$ (0.02)
Weighted average shares:					
Basic	35,849	35,617	34,204	32,438	30,978
Diluted	35,849	35,617	34,615	32,897	30,978

	As of December 31,				
	2012	2011	2010	2009	2008
<b>Consolidated Balance Sheet Data (in thousands):</b>					
Total assets	\$ 54,395	\$ 79,941	\$ 234,892	\$ 205,934	\$ 176,995
Total liabilities	11,733	15,081	16,627	17,955	11,591
Accumulated comprehensive earnings (deficit)	(168,539)	(143,103)	16,528	4,190	(491)
Total stockholders' equity	\$ 42,662	\$ 64,860	\$ 218,265	\$ 187,979	\$ 165,404

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

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Annual Report. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation the disclosures made in Item 1A of Part I of this Annual Report under the caption "Risk Factors."

Risk factors that could cause actual results to differ from those contained in the forward-looking statements include but are not limited to: deriving revenues from a small number of products; our dependence upon the large carrier customers for a significant portion of our revenues; potential fluctuations in quarterly results; potential further impairments of long-lived assets; our failure to successfully compete; changes in technology; our entry into new markets; failure of our customers to adopt new technologies; loss of key personnel; failure to maintain strategic relationships with device manufacturers; failure of our products to achieve broad acceptance; uncertainty and volatility of current global economic conditions; our failure to successfully integrate acquisitions; undetected software defects; our failure to protect intellectual property; exposure to intellectual property claims; security and privacy breaches in our systems or interruptions or delays in the services we provide which could damage client relations; our inability to raise more funds to meet our capital needs; being delisted from NASDAQ; and doing business internationally.

### Introduction and Overview

Smith Micro Software, Inc. provides software and services that simplify, secure and enhance the mobile experience. The Company's portfolio of wireless solutions includes a wide range of client and server applications that manage voice, data, video and connectivity over mobile broadband networks. Our primary customers are the world's leading mobile network operators, mobile device manufacturers and enterprise businesses. In addition to our wireless and mobility software, Smith Micro offers personal productivity and graphics products distributed through a variety of consumer channels worldwide.

The proliferation of mobile broadband technology continues to provide new opportunities for Smith Micro on a global basis. Over the last decade, the Company has developed extensive expertise in embedded software for networked devices (both wireless and wired), and we have leveraged that expertise to solve an unending tide of connectivity and mobile service challenges for our customers. As network operators and businesses struggle to reduce costs and complexity in a market that is characterized by rapid evolution and fragmentation, Smith Micro answers with innovative solutions that increase reliability, security, performance, efficiency, and usability of wireless services over a wide variety of networks and device platforms.

The underlying philosophy driving our products and services is our desire to improve the user experience and optimize resources for our customers. These objectives are delivered through the combination of rigorous market analysis and planning, technology innovation that leverages substantial intellectual property, leadership in industry standards, quality engineering, and extensive commercial deployment experience gained over 30 years. As technology, market dynamics and consumer demands change, Smith Micro has proven its ability to evolve and meet those demands again and again.

During fiscal year 2011, we experienced a significant decrease in our revenues. This was primarily due to the introduction and market acceptance of mobile hotspot devices, Tablets and Smartphones capable of functioning as a WWAN hotspot, resulting in lower demand in our North American marketplace for our core connection management products. While we launched new wireless products that addressed this technology shift, they are new to the market and their rate of adoption and deployment is unknown at this time causing material uncertainty regarding the timing of our future wireless revenues.

As a result of our decreased revenues, slow adoption of our new products, operating losses and depressed stock prices, we recorded a goodwill and other long-lived asset impairment charge of \$112.9 million in fiscal year 2011. All goodwill and intangible assets have been written off as of December 31, 2011.

For the year ended December 31, 2012, revenues to two customers and their respective affiliates in the Wireless business segment accounted for 40.7% and 20.5% of the Company's total revenues and 78% of accounts receivable. For the year ended December 31, 2011, revenues to three customers and their respective affiliates in the Wireless business segment accounted for 24.8%, 18.4% and 11.7% of the Company's total revenues and 63% of accounts receivable. For the year ended December 31, 2010, revenues to three customers and their respective affiliates in the Wireless business segment accounted for 40.1%, 13.9% and 12.3% of the Company's total revenues and 78% of accounts receivable.

## Results of Operations

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

	Year Ended December 31,		
	2012	2011	2010
Revenues	100.0 %	100.0 %	100.0 %
Cost of revenues	19.5	23.8	11.9
Gross profit	80.5	76.2	88.1
Operating expenses:			
Selling and marketing	38.5	46.0	22.8
Research and development	57.2	72.2	32.8
General and administrative	46.6	43.8	18.4
Restructuring expenses	0.5	5.5	-
Goodwill and long-lived asset impairment	-	195.5	-
Total operating expenses	142.8	363.0	74.0
Operating income (loss)	(62.3)	(286.8)	14.1
Non-operating income:			
Change in fair value of contingent liability	2.8	-	-
Interest and other income, net	0.2	0.2	0.1
Income (loss) before provision for income taxes	(59.3)	(286.6)	14.2
Provision for income tax expense (benefit)	(0.5)	(10.3)	4.7
Net income (loss)	<u>(58.8) %</u>	<u>(276.3) %</u>	<u>9.5 %</u>

### *Revenues and Expense Components*

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

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

- Wireless, which includes our QuickLink, NetWise and CommSuite family of products; and
- Productivity & Graphics, which includes our consumer-based products: Poser, Anime Studio, Manga Studio, MotionArtist and StuffIt.

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

	Year Ended December 31,		
	2012	2011	2010
Wireless	\$ 36,963	\$ 48,711	\$ 118,684
Productivity & Graphics	6,175	8,816	11,399
Corporate/Other	191	240	418
Total revenues	43,329	57,767	130,501
Cost of revenues	8,448	13,761	15,507
Gross profit	\$ 34,881	\$ 44,006	\$ 114,994

“Corporate/Other” refers to the consulting portion of our services sector which has been de-emphasized and is not considered a strategic element of our future plans.

*Cost of revenues.* Cost of revenues consists of direct product costs, royalties, and the amortization of purchased intangibles and capitalized software.

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

*Research and development.* Research and development expenses consist primarily of personnel and equipment costs required to conduct our software development efforts and the amortization of certain acquired intangibles.

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

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

*Goodwill and long-lived asset impairment.* Goodwill and long-lived asset impairment charges are a result of determining that the recoverability of the carrying value of goodwill, intangible assets, and fixed assets will not be realized.

*Change in fair value of contingent liability.* This is the return-to-profit of a milestone payment accrual that we did not have to pay.

*Interest and other income, net.* Interest and other income, net is primarily related to our average cash and short term investment balances during the period and vary among periods. Our other excess cash is invested in short term marketable equity and debt securities classified as cash equivalents.

*Provision for income tax expense (benefit).* The Company accounts for income taxes as required by Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic No. 740, Income Taxes. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in the Company’s financial statements or tax returns. Measurement of the deferred items is based on enacted tax laws.



In the event the future consequences of differences between financial reporting bases and tax bases of the Company's assets and liabilities result in a deferred tax asset, we are required to evaluate the probability of being able to realize the future benefits indicated by such asset. The deferred tax assets are reduced by a valuation allowance if, based upon all available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. Establishing, reducing or increasing a valuation allowance in an accounting period generally results in an increase or decrease in tax expense in the statement of operations. We must make significant judgments to determine the provision for income taxes, deferred tax assets and liabilities, unrecognized tax benefits and any valuation allowance to be recorded against deferred tax assets. After consideration of the Company's three year cumulative loss position as of December 31, 2011 and sources of taxable income, the Company recorded a valuation allowance related to its U.S.-based deferred tax amounts, with a corresponding charge to income tax expense, of \$53.2 million for the year ended December 31, 2011.

### ***Year Ended December 31, 2012 Compared to the Year Ended December 31, 2011***

*Revenues.* Revenues of \$43.3 million for fiscal year 2012 decreased \$14.5 million, or 25.0%, from \$57.8 million for fiscal year 2011. Wireless revenues of \$36.9 million decreased \$11.8 million, or 24.1%, primarily due to lower sales of our base business connection manager products to our carrier customers of \$15.5 million and PC OEM customers of \$3.2 million, partially offset by higher sales of our CommSuite products of \$3.9 million and NetWise products of \$3.0 million. Productivity & Graphics sales decreased \$2.6 million, or 30.0%, primarily due to lower sell through at large retailers and lower overall demand. Corporate/Other sales decreased \$0.1 million as we continue to de-emphasize this business. Due to the introduction and market acceptance of mobile hotspot devices, Tablets and Smartphones capable of functioning as a WWAN hotspot, our core connection management products continue to experience lower demand in our North American marketplace. We have launched new wireless products and services, but they are new to the market and their rate of adoption and deployment is unknown at this time causing material uncertainty regarding the timing of our future wireless revenues.

*Cost of revenues.* Cost of revenues of \$8.4 million for fiscal year 2012 decreased \$5.4 million, or 38.6%, from \$13.8 million for fiscal year 2011. Amortization of intangibles decreased \$3.8 million due to the impairment charge we recorded for these assets in fiscal year 2011. There was no amortization of intangibles in fiscal year 2012. Direct product costs decreased \$1.6 million primarily due to cost reductions.

*Gross profit.* Gross profit of \$34.9 million or 80.5% of revenues for fiscal year 2012 decreased \$9.1 million, or 20.7%, from \$44.0 million, or 76.2% of revenues for fiscal year 2011. The 4.3 percentage point increase in gross profit was primarily due to no amortization of intangibles in fiscal year 2012 of 6.5 points, partially offset by lower product margins of 2.2 points as a result of the lower revenues not absorbing our fixed overhead costs.

*Selling and marketing.* Selling and marketing expenses of \$16.7 million for fiscal year 2012 decreased \$9.9 million, or 37.3%, from \$26.6 million for fiscal year 2011. This decrease was primarily due to lower personnel related expenses of \$5.8 million and lower third party commissions and advertising costs of \$0.8 million. Amortization of intangibles decreased \$2.1 million due to the impairment charge we recorded for these assets in fiscal year 2011. There was no amortization of intangibles in fiscal year 2012. Stock-based compensation decreased from \$2.1 million to \$0.9 million.

*Research and development.* Research and development expenses of \$24.8 million for fiscal year 2012 decreased \$16.9 million, or 40.6%, from \$41.7 million for fiscal year 2011. Personnel related, travel and supplies and equipment expenses decreased \$16.1 million. Stock-based compensation decreased from \$1.4 million to \$0.8 million, or \$0.6 million. Amortization of purchased technologies decreased \$0.2 million due to the impairment charge we recorded for these assets in fiscal year 2011. There was no amortization of purchased technologies in fiscal year 2012.

*General and administrative.* General and administrative expenses of \$20.2 million for fiscal year 2012 decreased \$5.0 million, or 20.0%, from \$25.2 million for fiscal year 2011. This decrease was primarily due to personnel related expenses of \$1.8 million, lower outside legal and accounting fees of \$0.7 million, and other cost reductions of \$0.6 million. Stock-based compensation expense decreased from \$4.3 million to \$2.4 million, or \$1.9 million.

*Restructuring expenses.* Restructuring expenses of \$0.2 million for fiscal year 2012 were related to one-time employee termination and other costs as a result of headcount reductions. Restructuring expenses of \$3.2 million for fiscal year 2011 were related to the Chicago facility shutdown of \$0.8 million, the Sweden facility shutdown of \$0.8 million and other one-time employee termination and other costs in the U.S. of \$1.6 million

*Goodwill and long-lived asset impairment.* There were no impairment charges in fiscal year 2012. Goodwill and long-lived asset impairment charges of \$112.9 million for fiscal year 2011 were related to goodwill of \$94.2 million, intangible assets of \$13.4 million, and fixed assets of \$5.3 million.

*Change in fair value of contingent liability.* When we acquired Core Mobility in October 2009, we established a pre-acquisition contingency made up of two milestone payments that were part of the purchase price of the business. The first milestone was met and \$0.6 million was paid in March 2010. The second milestone was not met and therefore not paid. The Core Mobility shareholders disputed the second milestone in a lawsuit which was found in our favor in August 2012. The plaintiffs chose not to appeal the decision. As a result, we have reduced the contingent liability of \$1.2 million to its fair value of \$0 at December 31, 2012.

*Interest and other income, net.* Interest and other income, net was \$0.1 million for both fiscal year 2012 and 2011.

*Provision for income tax expense (benefit).* We recorded an income tax benefit of \$0.2 million for fiscal year 2012 related to state R&D tax credits of \$0.7 million, partially offset by state and foreign income taxes of \$0.5 million. We recorded an income tax benefit of \$5.9 million for fiscal year 2011. The effective tax rate for fiscal year 2011 was impacted by the valuation allowance and carryback of losses to offset taxable income in prior years.

### ***Year Ended December 31, 2011 Compared to the Year Ended December 31, 2010***

*Revenues.* Revenues of \$57.8 million for fiscal year 2011 decreased \$72.7 million, or 55.7%, from \$130.5 million for fiscal year 2010. Wireless revenues of \$48.7 million decreased \$70.0 million, or 59.0%, primarily due to lower sales of our base business connection manager products to our carrier customers of \$58.3 million and PC OEM customers of \$8.3 million and large device solutions sales in fiscal 2010 that were not repeated in fiscal 2011 of \$3.4 million. Productivity & Graphics sales decreased \$2.6 million, or 22.7%, primarily due to low consumer spending and moving toward a more internal distribution model. Corporate/Other sales decreased \$0.1 million as we continue to de-emphasize this business. Due to the introduction and market acceptance of mobile hotspot devices, Tablets and Smartphones capable of functioning as a WWAN hotspot, our core connection management products experienced lower demand in our North American marketplace. While we have launched new wireless products that address this technology shift, they are new to the market and their rate of adoption and deployment is unknown at this time causing material uncertainty regarding the timing of our future wireless revenues.

*Cost of revenues.* Cost of revenues of \$13.8 million for fiscal year 2011 decreased \$1.7 million, or 11.3%, from \$15.5 million for fiscal year 2010. Direct product costs increased \$0.4 million primarily due to costs associated with the start-up of our new backup and messaging services. Amortization of intangibles decreased from \$5.9 million to \$3.8 million, or \$2.1 million, primarily due to the impairment charge we recorded for these assets in fiscal year 2011. No future amortization of intangibles is anticipated as these assets have been fully impaired.

*Gross profit.* Gross profit of \$44.0 million or 76.2% of revenues for fiscal year 2011 decreased \$71.0 million, or 61.7%, from \$115.0 million, or 88.1% of revenues for fiscal year 2010. The 11.9 percentage point decrease in gross profit was primarily due to lower product margins of 9.9 points as a result of the lower revenues not absorbing our fixed costs and our datacenter and start-up costs associated with our backup and messaging products. Amortization of intangibles as a percentage of revenues decreased 2.0 points primarily due to the lower revenues and the impairment charge we recorded in fiscal 2011.

*Selling and marketing.* Selling and marketing expenses of \$26.6 million for fiscal year 2011 decreased \$3.1 million, or 10.5%, from \$29.7 million for fiscal year 2010. This decrease was primarily due to lower personnel related expenses of \$0.9 million, lower advertising costs of \$0.2 million and lower travel costs of \$0.1 million. Stock-based compensation decreased from \$3.1 million to \$2.1 million, or \$1.0 million. Amortization of intangibles decreased from \$3.0 million to \$2.1 million, or \$0.9 million. No future amortization of intangibles is anticipated as these assets have been fully impaired.

*Research and development.* Research and development expenses of \$41.7 million for fiscal year 2011 decreased \$1.0 million, or 2.5%, from \$42.7 million for fiscal year 2010. Personnel, recruiting and travel expenses decreased \$0.4 million as a result of implementing our restructuring plans. This decrease was offset by increases in software maintenance and other small equipment of \$0.6 million related to our new products. Stock-based compensation decreased from \$2.7 million to \$1.4 million, or \$1.3 million. Amortization of purchased technologies increased from \$0.1 million to \$0.2 million, or \$0.1 million. No future amortization of purchased technologies is anticipated as these assets have been fully impaired.

*General and administrative.* General and administrative expenses of \$25.2 million for fiscal year 2011 increased \$1.1 million, or 4.7%, from \$24.1 million for fiscal year 2010. This increase was primarily due to increased space and occupancy costs and depreciation/amortization associated with facility and datacenter expansions in Aliso Viejo and Pittsburgh of \$2.7 million and legal expenses of \$0.8 million, partially offset by lower personnel related costs of \$0.8 million and other cost decreases of \$0.2 million. Stock-based compensation expense decreased from \$5.7 million to \$4.3 million, or \$1.4 million.

*Restructuring expenses.* Restructuring expenses of \$3.2 million for fiscal year 2011 were related to the Chicago facility shutdown of \$0.8 million, the Sweden facility shutdown of \$0.8 million and other one-time employee termination and other costs in the U.S. of \$1.6 million. There were no restructuring expenses in 2010.

*Goodwill and long-lived asset impairment.* Goodwill and long-lived asset impairment charges of \$112.9 million for fiscal year 2011 were related to goodwill of \$94.2 million, intangible assets of \$13.4 million, and fixed assets of \$5.3 million. There were no impairment charges in 2010.

*Interest and other income, net.* Interest and other income, net was \$0.1 million for both fiscal year 2011 and 2010.

*Provision for income tax expense (benefit).* We recorded an income tax benefit of \$5.9 million for fiscal year 2011 and a tax provision of \$6.2 million for fiscal year 2010. The effective tax rate for fiscal year 2011 was impacted by the valuation allowance and carryback of losses to offset taxable income in prior years.

## Liquidity and Capital Resources

At December 31, 2012, we had \$32.2 million in cash and cash equivalents and short-term investments and \$34.8 million of working capital.

In November 2011, the Company announced that its Board of Directors had approved a program authorizing the repurchase of up to five million shares of the Company's common stock over a period of up

to two years. Under this program, stock repurchases may be made from time to time and the actual amount expended will depend on a variety of factors including market conditions, regulatory and legal requirements, corporate cash generation and other factors. The stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of Rule 10b5-1 trading plans. The program does not obligate Smith Micro to repurchase any particular amount of common stock during any period and the program may be modified or suspended at any time at the Company's discretion. During the fiscal year 2012 we repurchased 375,000 shares at a cost of \$0.8 million.

Capital expenditures were only \$0.3 million for the fiscal year 2012 versus \$13.4 million for the fiscal year 2011 as we expanded our Aliso Viejo datacenter and built out our new Pittsburgh facility in 2011.

We believe that our existing cash, cash equivalents and short-term investment balances will be sufficient to finance our working capital and capital expenditure requirements through at least the next twelve months. We are hopeful that our new products will gain market acceptance in order to increase our revenues in upcoming quarters. If our new products do not gain market acceptance, or market acceptance is slower than anticipated, then we anticipate that it will be necessary to undertake additional restructuring to lower costs to bring them more in line with actual revenues, thus slowing the use of cash. 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.

### ***Operating Activities***

In 2012, net cash used in operations was \$12.8 million primarily due to our net loss adjusted for depreciation, amortization, non-cash stock-based compensation, and inventory and accounts receivable reserves of \$17.0 million, a decrease of accounts payable and accrued liabilities of \$2.2 million, and an increase in accounts receivable of \$1.5 million. This usage was partially offset by a decrease of income taxes receivable of \$7.6 million and a decrease in prepaid and other assets of \$0.3 million.

In 2011, net cash used in operations was \$13.5 million primarily due to our net loss adjusted for goodwill and long-lived asset impairments, depreciation, amortization, non-cash stock-based compensation, deferred income taxes and inventory and accounts receivable reserves of \$28.0 million, an increase of income taxes receivable of \$5.4 million and a decrease in accounts payable and accrued liabilities of \$2.3 million. This usage was partially offset by a decrease in accounts receivable of \$20.0 million and lease incentives of \$2.2 million.

In 2010, net cash provided by operations was \$24.7 million primarily due to our net income adjusted for depreciation, amortization, non-cash stock-based compensation, deferred income taxes and inventory and accounts receivable reserves of \$34.0 million and a decrease in prepaid expenses of \$0.3 million. These increases were partially offset by an increase of accounts receivable due to our increased revenue of \$6.5 million, an increase in income tax receivable of \$1.9 million and an increase of all other net assets of \$1.2 million.

### ***Investing Activities***

In 2012, cash provided by investing activities of \$24.9 million was due to the sale of short-term investments of \$25.2 million, partially offset by capital expenditures of \$0.3 million.

In 2011, cash provided by investing activities of \$2.7 million was due to the sale of short-term investments of \$16.1 million, partially offset by capital expenditures of \$13.4 million which were primarily for leasehold improvements and to expand our datacenters.

In 2010, we used cash of \$30.3 million for investing activities to purchase short-term investments of \$23.4 million, capital expenditures which primarily were for leasehold improvements and to expand our datacenter of \$6.3 million, and for the acquisition of Avot Media of \$0.6 million.

### **Financing Activities**

In 2012, cash used in financing activities of \$0.7 million was due to the repurchase of our common stock of \$0.8 million which was partially offset by cash received from the sale of stock for our employee stock purchase plan of \$0.1 million.

In 2011, cash provided by financing activities of \$0.4 million was from the sale of stock for our employee stock purchase plan.

In 2010, cash provided by financing activities of \$8.8 million was related to the exercise of stock options of \$7.3 million and tax benefits associated with stock-based compensation of \$1.5 million.

### **Contractual Obligations and Commercial Commitments**

As of December 31, 2012, we had no debt. The following table summarizes our contractual obligations as of December 31, 2012 (in thousands):

<b>Contractual obligations:</b>	<b>Payments due by period</b>				
	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Operating lease obligations	\$ 17,870	\$ 2,611	\$ 5,030	\$ 3,915	\$ 6,314
Purchase obligations	778	778	-	-	-
<b>Total</b>	<b>\$ 18,648</b>	<b>\$ 3,389</b>	<b>\$ 5,030</b>	<b>\$ 3,915</b>	<b>\$ 6,314</b>

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

### **Real Property Leases**

Our corporate headquarters, including our principal administrative, sales and marketing, customer support and research and development facility, is located in Aliso Viejo, California, where we currently lease and occupy approximately 52,700 square feet of space pursuant to leases that expire on May 31, 2016 and January 31, 2022. We lease approximately 55,600 square feet in Pittsburgh, Pennsylvania under a lease that expires December 31, 2021. We lease approximately 16,000 square feet in Sunnyvale, California under a lease that expires February 28, 2015. We lease approximately 15,300 square feet in Watsonville, California under a lease that expires September 30, 2018. Internationally, we lease space in Belgrade, Serbia that expires December 30, 2016 and Vancouver, Canada that expires March 31, 2014.

### **Off-Balance Sheet Arrangements**

As of December 31, 2012, we did not have any off-balance sheet arrangements.

## Critical Accounting Policies and Estimates

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

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

### *Revenue Recognition*

We currently report our net revenues under two operating groups: Wireless and Productivity & Graphics. Within each of these groups software revenue is recognized based on the customer and contract type. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectability is probable as required by FASB ASC Topic No. 985-605, Software-Revenue Recognition. We recognize revenues from sales of our software to our customers or end users as completed products are shipped and title passes; or from royalties generated as authorized customers duplicate our software, if the other requirements are met. If the requirements are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. For Wireless sales, returns from customers are limited to defective goods or goods shipped in error. Historically, customer returns have not exceeded the very nominal estimates and reserves. We also provide some technical support to our customers. Such costs have historically been insignificant.

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

For Productivity & Graphics sales, management reviews available retail channel information and makes a determination of a return provision for sales made to distributors and retailers based on current channel inventory levels and historical return patterns. Certain sales to distributors or retailers are made on a consignment basis. Revenue for consignment sales are not recognized until sell through to the final customer is established. Certain revenues are booked net of revenue sharing payments. Sales directly to end-users are recognized upon shipment. End users have a thirty day

right of return, but such returns are reasonably estimable and have historically been immaterial. We also provide technical support to our customers. Such costs have historically been insignificant.

### ***Sales Incentives***

For our Productivity & Graphics sales, 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 as required by FASB ASC Topic No. 985-605, Software-Revenue Recognition. We use historical redemption rates to estimate the cost of customer incentives. Total sales incentives were \$0.9 million, \$1.2 million, and \$2.0 million for the years ended December 31, 2012, 2011 and 2010, respectively.

### ***Accounts Receivable and Allowance for Doubtful Accounts***

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

### ***Internal 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, 2012, software has been substantially completed concurrently with the establishment of technological feasibility; accordingly, no costs have been capitalized to date.

### ***Impairment of Goodwill and Long-Lived Assets***

During the period ended September 30, 2011, the Company concluded that a decline in its stock price and market capitalization was representative of the fair value of the reporting unit as a whole.

The triggering events that led us to this conclusion were:

- Revenues - declined for the third consecutive quarter.
- New product launches – although we were in trials for several of our new products, as of September 30, 2011 we had not realized any revenues from these new products.
- Profitability – declined for the third consecutive quarter.
- Stock price – remained at depressed prices.

As such, the Company performed Step 1 of the goodwill impairment test which failed, triggering Step 2. As a result of this analysis, the excess of the carrying value of goodwill was compared to the implied fair value of goodwill and resulted in an impairment loss of \$94.2 million in the fiscal quarter ended September 30, 2011.

As a result of the triggering events described above in our goodwill impairment analysis, the Company reviewed its long-lived assets for recoverability. As a result of this analysis, the Company recognized a long-lived asset impairment charge of \$18.7 million in the fiscal quarter ended

September 30, 2011 which was allocated pro-rata to the intangible assets of \$13.4 million and \$5.3 million to equipment and improvements, primarily related to our leasehold improvements.

As a result of the \$112.9 million goodwill and long-lived asset impairment charge recorded in the fiscal quarter ended September 30, 2011, there were no more goodwill or intangible assets on the balance sheet as of that date.

### ***Income Taxes***

We account for income taxes as required by FASB ASC Topic No. 740, Income Taxes. This Topic clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Topic also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. 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, we are required to evaluate the probability of being able to realize the future benefits indicated by such asset. The Company records a valuation allowance to reduce any deferred tax assets by the amount of any tax benefits that, based on available evidence and judgment, are not expected to be realized.

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

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. A significant factor in the Company's assessment is that the Company was in a three-year historical cumulative loss as of the end of fiscal 2011. This fact, combined with uncertain near-term market and economic conditions, reduced the Company's ability to rely on projections of future taxable income in assessing the realizability of its deferred tax assets.

After a review of the four sources of taxable income as of December 31, 2011 (as described above), and after consideration of the Company's three-year cumulative loss position as of December 31, 2011, the Company recorded a valuation allowance related to its U.S.-based deferred tax amounts, with a corresponding charge to income tax expense, of \$53.2 million during the year ended December 31, 2011.

### ***Stock-Based Compensation***

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

### ***Recent Accounting Pronouncements***

In December 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-12, *Comprehensive Income (Topic 220)*. The amendments in this Update supersede certain pending paragraphs in ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of*



*Comprehensive Income*, to effectively defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. The amendments will be temporary to allow the Board time to redeliberate the presentation requirements for reclassifications out of accumulated other comprehensive income for annual and interim financial statements for public, private, and non-profit entities.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. Under the amendments to this Update, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company has implemented this guidance.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurements and Disclosures (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The Company has implemented this guidance and its adoption has not had an impact on its consolidated results of operations and financial condition.

## **Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### **Interest Rate Risk**

Our financial instruments include cash and cash equivalents, and short-term investments. At December 31, 2012, the carrying values of our financial instruments approximated fair values based on current market prices and rates.

### **Foreign Currency Risk**

While a majority of our business is denominated in U.S. dollars, we do occasionally invoice in foreign currencies. For the three years ended December 31, 2012, 2011 and 2010, our revenues denominated in foreign currencies were \$0.6 million, \$1.1 million, and \$1.7 million, respectively. Fluctuations in the rate of exchange between the U.S. dollar and certain other currencies may affect our results of operations and period-to-period comparisons of our operating results. We do not currently engage in hedging or similar transactions to reduce these risks. The operational expenses of our foreign entities reduce the currency exposure we have because our foreign currency revenues are offset in part by expenses payable in foreign currencies. As such, we do not believe we have a material exposure to foreign currency rate fluctuations at this time.

## **Item 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.

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

None.

## **Item 9A. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 (“Exchange Act”)) as of December 31, 2012. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have determined that as of December 31, 2012, our disclosure controls and procedures were effective to ensure that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

### **Management’s Responsibility for Financial Statements**

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

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

### **Changes in Internal Control over Financial Reporting**

There have been no changes in our internal controls over financial reporting during the quarter ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **Report of Management on Internal Control Over Financial Reporting**

Our management, including the Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934).

Our management, including the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2012. Management based this assessment on criteria for effective internal control over financial reporting described in “Internal Control—Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, management determined that, as of December 31, 2012, we maintained effective internal control over financial reporting.

SingerLewak LLP, an independent registered public accounting firm, who audited the consolidated financial statements included in this Annual Report on Form 10-K, has also audited the effectiveness of our internal control over financial reporting as stated in its report appearing elsewhere in this Annual Report on Form 10-K.

## **Item 9B. OTHER INFORMATION**

None.

## PART III

### Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth certain information regarding our executive officers and certain key officers as of February 15, 2013:

Name	Age	Position
William W. Smith, Jr.	65	Chairman of the Board, President and Chief Executive Officer
Andrew C. Schmidt	51	Vice President and Chief Financial Officer
Von Cameron	49	Executive Vice President – Worldwide Sales
Rick Carpenter	50	Senior Vice President – Engineering
Chris G. Lippincott	41	Senior Vice President – Global Operations
David P. Sperling	44	Vice President and Chief Technology Officer
Steven M. Yasbek	59	Chief Accounting Officer

*Mr. Smith* co-founded Smith Micro and has served as the 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. in Finance from the University of Texas and an M.S. in Accountancy from San Diego State University.

*Mr. Cameron* joined the Company in April of 2008 as the Executive Vice President of Worldwide Sales. Mr. Cameron has held executive management positions with Openwave, Oracle, FoxT and Booz Allen & Hamilton. Mr. Cameron served proudly in the United States Air Force and earned his B.S. in Math-Operations Research from the United States Air Force Academy in Colorado, Springs, CO and an M.B.A. from Golden Gate University in San Francisco, California.

*Mr. Carpenter* joined the Company in May of 2009 as the Vice President of Engineering for the Company's Connectivity & Security Business Unit and then served as the Vice President and General Manager of the Wireless Business Unit. Mr. Carpenter currently serves as the Senior Vice President of Engineering. Prior to joining Smith Micro, Mr. Carpenter served as a Vice President of Engineering at NextWave Wireless where he was responsible for WiMAX chipset development. From 2000 to 2005, he was Director of Software Engineering for CDMA products at AirPrime, which was ultimately acquired by Sierra Wireless. Mr. Carpenter has also held engineering management positions at Motorola and DENSO Wireless and started his professional career in May of 1986. He holds a BS in Computer Science from the University of Texas, Permian Basin and studied Masters-level Computer Science & Engineering at the University of Texas Arlington.

*Mr. Lippincott* joined the Company in February of 1993. From 1993 to 2000, Mr. Lippincott held various sales positions within the company including Director of OEM Sales, Director of Retail Sales and Vice President of

Enterprise Sales. In 2000, Mr. Lippincott began serving as General Manager of the company's Internet Solutions Division, until 2004 when he accepted the role of Vice President, Worldwide Operations. Mr. Lippincott currently serves as the Senior Vice President of Global Operations. Mr. Lippincott attended the University of California, Berkeley studying Business Administration.

*Mr. Sperling* joined the Company in April 1989 and has been the 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 two patents and three patents pending for various telephony and Internet technologies. Mr. Sperling holds a B.S. degree in Computer Science and an MBA from the University of California, Irvine.

*Mr. Yasbek* joined the Company in May of 2008 as the Chief Accounting Officer. Mr. Yasbek has held executive finance and information technology positions with REMEC, Paradigm Wireless Systems, Intellisys Group, Pacific Scientific Company, Symbol Technologies, TRW, and most recently as Chief Financial Officer of Alphatec Spine. He holds a B.S. in Accounting and M.B.A from Loyola Marymount University, and is a Certified Public Accountant.

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

For information about our Directors, please see the section titled "Directors and Executive Officers" appearing in our Proxy Statement for our 2013 Annual Meeting of Stockholders, which is hereby incorporated by reference.

The section titled "Corporate Governance" appearing in our Proxy Statement for our 2013 Annual Meeting of Stockholders is hereby incorporated by reference.

## **Audit Committee; Audit Committee Financial Expert**

Our Board of Directors has a standing Audit Committee. The members of the Audit Committee are Messrs. Arno, 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 ten 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 persons, the Company believes that all filing requirements applicable to our executive officers, directors and more than 10% stockholders were met in a timely manner in 2012.

## **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](http://www.smithmicro.com).

## Item 11. EXECUTIVE COMPENSATION

The section titled “Executive Compensation and Related Information” appearing in our Proxy Statement for our 2013 Annual Meeting of Stockholders is hereby incorporated by reference.

## Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The section titled “Ownership of Securities and Related Stockholder Matters” appearing in our Proxy Statement for our 2013 Annual Meeting of Stockholders is hereby incorporated by reference.

### Securities Authorized for Issuance Under An Equity Compensation Plan

The following table provides information as of December 31, 2012 with respect to the shares of common stock that may be issued under our existing equity compensation plans:

(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)	2,275	\$7.02	2,266
Equity compensation plan not approved by shareholders	-	-	-
Total	2,275	\$7.02	2,266

(1) The number of shares to be issued upon 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, AND DIRECTOR INDEPENDENCE

The section titled “Related Party Transactions” and “Director Independence” appearing in our Proxy Statement for our 2013 Annual Meeting of Stockholders 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 for our 2013 Annual Meeting of Stockholders 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:

	<u>Page</u>
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM.....	F-1
CONSOLIDATED BALANCE SHEETS.....	F-3
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME .....	F-4
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY .....	F-5
CONSOLIDATED STATEMENTS OF CASH FLOWS .....	F-6
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.....	F-7

#### (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.

	<u>Page</u>
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS .....	S-1

#### (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.	Incorporated by reference to Exhibit 3.1.2 to the Registrant's Annual Report on Form 10-K for the period ended December 31, 2005.
3.1.3	Certificate of Designations of Series A Junior Participating Preferred Stock of Smith Micro Software, Inc. dated April	Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on April 25, 2012.

<b>Exhibit No.</b>	<b>Title</b>	<b>Method of Filing</b>
	25, 2012.	
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.
3.3	Certificate of Amendment of Amended and Restated Bylaws of Smith Micro Software, Inc.	Incorporated by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8-K filed on October 31, 2007.
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.
4.2	Stockholder Rights Agreement, dated as of April 24, 2012, between Smith Micro Software, Inc. and Computershare Trust Company, N.A., as Rights Agent.	Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on April 25, 2012.
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	Amended and Restated 2005 Stock Option / Stock Issuance Plan.	Incorporated by reference to Exhibit 10.7 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-149222).
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.
10.4.3†	Amendment No. 6 to the Master Software License and Distribution Agreement (Contract No. 220-00-0134).	Incorporated by reference to Exhibit 10.4.3 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2009.
10.4.4†	Amendment No. 7 to the Master Software License and Distribution Agreement (Contract No. 220-00-0134).	Incorporated by reference to Exhibit 10.4.4 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2009.
10.4.5†	Amendment No. 9 to the Master Software License and Distribution Agreement (Contract No. 220-00-0134).	Incorporated by reference to Exhibit 10.4.5 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2009.
10.5	Letter Agreement, dated June 13, 2005, by and between Smith Micro Software, Inc. and Andrew Schmidt.	Incorporated by reference to Exhibit 10.5 to the Registrant's Current Report on Form 8-K filed on November 30, 2006.



<b>Exhibit No.</b>	<b>Title</b>	<b>Method of Filing</b>
10.6	Summary of oral agreement dated June 2005 by and between William W. Smith, Jr. and the Registrant.	Incorporated by reference to Exhibit 10.10 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009.
10.7	Amended & Restated Employee Stock Purchase Plan.	Incorporated by reference to Exhibit 10.11 to the Registrant's Registration Statement on Form S-8 (No. 333-169671) filed on September 30, 2010.
14.1	Code of Ethics.	Incorporated by reference to Exhibit 14.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.
14.1.1	Attachment 1 to Code of Ethics.	Incorporated by reference to Exhibit 14.1.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2003.
21.1	Subsidiaries.	Filed herewith.
23.1	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 2002.	Furnished herewith.
*** 101.INS XBRL Instance Document *** 101.SCH XBRL Taxonomy Extension Schema Document *** 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document *** 101.DEF XBRL Taxonomy Extension Definition Linkbase Document *** 101.LAB XBRL Taxonomy Extension Label Linkbase Document *** 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document		

† 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.

\*\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

**(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: February 20, 2013

By: /s/ William W. Smith, Jr.  
William W. Smith, Jr.  
Chairman of the Board,  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: February 20, 2013

By: /s/ Andrew C. Schmidt  
Andrew C. Schmidt,  
Vice President and 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)	February 20, 2013
/s/ Andrew C. Schmidt Andrew C. Schmidt	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	February 20, 2013
/s/ Andrew Arno Andrew Arno	Director	February 20, 2013
/s/ Thomas G. Campbell Thomas G. Campbell	Director	February 20, 2013
/s/ Samuel Gulko Samuel Gulko	Director	February 20, 2013
/s/ Gregory J. Szabo Gregory J. Szabo	Director	February 20, 2013

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Smith Micro Software, Inc. and subsidiaries (collectively, the “Company”) as of December 31, 2012 and 2011, and the related consolidated statements of comprehensive income, stockholders’ equity and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule of the Company listed in Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements 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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U. S. generally accepted accounting principles. Also, in our opinion, the related 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.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 20, 2013 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

/s/ SINGERLEWAK LLP  
Los Angeles, California  
February 20, 2013

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited Smith Micro Software Inc. and subsidiaries' (collectively, the "Company") internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying "Report of Management on Internal Control over Financial Reporting." Our responsibility is to express an opinion on the Company's internal control over financial reporting 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (a) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (b) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (c) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows, and the financial statement schedule, for each of the three years in the period ended December 31, 2012 of the Company, and our report dated February 20, 2013 expressed an unqualified opinion.

/s/ SINGERLEWAK LLP  
Los Angeles, California  
February 20, 2013

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

	December 31,	
	2012	2011
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 18,873	\$ 7,475
Short-term investments	13,328	38,497
Accounts receivable, net of allowances for doubtful accounts and other adjustments of \$482 (2012) and \$1,382 (2011)	8,953	8,525
Income tax receivable	681	8,293
Inventories, net of reserves for excess and obsolete inventory of \$352 (2012) and \$417 (2011)	176	309
Prepaid expenses and other current assets	903	1,138
Deferred tax asset	89	8
Total current assets	43,003	64,245
Equipment and improvements, net	11,211	15,482
Other assets	181	214
Total assets	\$ 54,395	\$ 79,941
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,978	\$ 3,181
Accrued liabilities	4,829	7,641
Deferred revenue	1,436	703
Total current liabilities	8,243	11,525
Non-current liabilities:		
Deferred rent and other long term liabilities	3,399	3,546
Deferred tax liability	91	10
Total non-current liabilities	3,490	3,556
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, par value \$0.001 per share; 5,000,000 shares authorized; none issued or outstanding	-	-
Common stock, par value \$0.001 per share; 100,000,000 shares authorized; 35,873,418 and 35,611,976 shares issued and outstanding at December 31, 2012 and December 31, 2011, respectively	36	36
Additional paid-in capital	211,165	207,927
Accumulated comprehensive deficit	(168,539)	(143,103)
Total stockholders' equity	42,662	64,860
Total liabilities and stockholders' equity	\$ 54,395	\$ 79,941

See accompanying notes to the consolidated financial statements.

**SMITH MICRO SOFTWARE, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in thousands, except per share amount)

	Year ended December 31,		
	2012	2011	2010
Revenues	\$ 43,329	\$ 57,767	\$ 130,501
Cost of revenues	8,448	13,761	15,507
Gross profit	34,881	44,006	114,994
Operating expenses:			
Selling and marketing	16,666	26,594	29,708
Research and development	24,767	41,711	42,759
General and administrative	20,211	25,279	24,146
Restructuring expenses	238	3,184	-
Goodwill and long-lived asset impairment	-	112,904	-
Total operating expenses	61,882	209,672	96,613
Operating income (loss)	(27,001)	(165,666)	18,381
Non-operating income:			
Change in fair value of contingent liability	1,210	-	-
Interest and other income, net	94	131	130
Income (loss) before provision for income taxes	(25,697)	(165,535)	18,511
Provision for income tax expense (benefit)	(234)	(5,929)	6,165
Net income (loss)	(25,463)	(159,606)	\$ 12,346
Other comprehensive income (loss), before tax:			
Unrealized holding gains (losses) on available-for-sale securities	33	(24)	(14)
Income tax expense (benefit) related to items of other comprehensive income (expense)	6	1	(6)
Other comprehensive income (expense), net of tax	27	(25)	(8)
Comprehensive income (loss)	\$ (25,436)	\$ (159,631)	\$ 12,338
Net income (loss) per share:			
Basic	\$ (0.71)	\$ (4.48)	\$ 0.36
Diluted	\$ (0.71)	\$ (4.48)	\$ 0.36
Weighted average shares outstanding:			
Basic	35,849	35,617	34,204
Diluted	35,849	35,617	34,615

See accompanying notes to the consolidated financial statements.

**SMITH MICRO SOFTWARE, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(in thousands)

	Common stock		Additional paid-in capital	Accumulated comprehensive income (deficit)	Total
	Shares	Amount			
<b>BALANCE, December 31, 2009</b>	<b>33,380</b>	<b>\$ 33</b>	<b>\$ 183,756</b>	<b>\$ 4,190</b>	<b>\$ 187,979</b>
Exercise of common stock options	760	1	7,254	-	7,255
Non cash compensation recognized on stock options and ESPP	-	-	4,559	-	4,559
Restricted stock grants, net of cancellations	868	1	4,936	-	4,937
Cancellation of shares for payment of withholding tax	(37)	-	(331)	-	(331)
Tax benefit related to the exercise of stock options	-	-	1,543	-	1,543
Tax benefit deficiencies related to restricted stock expense	-	-	(15)	-	(15)
Comprehensive income	-	-	-	12,338	12,338
<b>BALANCE, December 31, 2010</b>	<b>34,971</b>	<b>\$ 35</b>	<b>\$ 201,702</b>	<b>\$ 16,528</b>	<b>\$ 218,265</b>
Exercise of common stock options	7	-	12	-	12
Non cash compensation recognized on stock options and ESPP	-	-	973	-	973
Restricted stock grants, net of cancellations	575	1	5,556	-	5,557
Cancellation of shares for payment of withholding tax	(37)	-	(303)	-	(303)
Employee stock purchase plan	96	-	413	-	413
Tax benefit deficiencies related to restricted stock expense	-	-	(426)	-	(426)
Comprehensive loss	-	-	-	(159,631)	(159,631)
<b>BALANCE, December 31, 2011</b>	<b>35,612</b>	<b>\$ 36</b>	<b>\$ 207,927</b>	<b>\$ (143,103)</b>	<b>\$ 64,860</b>
Exercise of common stock options	32	-	16	-	16
Non cash compensation recognized on stock options and ESPP	-	-	66	-	66
Restricted stock grants, net of cancellations	574	-	3,883	-	3,883
Cancellation of shares for payment of withholding tax	(23)	-	(40)	-	(40)
Employee stock purchase plan	53	-	66	-	66
Shares repurchased and cancelled	(375)	-	(753)	-	(753)
Comprehensive loss	-	-	-	(25,436)	(25,436)
<b>BALANCE, December 31, 2012</b>	<b>35,873</b>	<b>\$ 36</b>	<b>\$ 211,165</b>	<b>\$ (168,539)</b>	<b>\$ 42,662</b>

See accompanying notes to the consolidated financial statements.

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

	Year ended December 31,		
	2012	2011	2010
<b>Operating activities:</b>			
Net income (loss)	\$ (25,463)	\$ (159,606)	\$ 12,346
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities, net of the effect of acquisitions:			
Depreciation and amortization	4,430	10,177	11,778
Goodwill and long-lived asset impairment	-	112,904	-
Change in fair value of contingent liability	(1,210)	-	-
Loss on disposal of fixed assets	163	181	29
Lease incentives	-	2,223	-
Provision for adjustments to accounts receivable and doubtful accounts	1,045	1,244	851
Provision for excess and obsolete inventory	73	158	203
Tax benefits from stock-based compensation	-	-	(1,543)
Non cash compensation related to stock options and restricted stock	3,949	6,530	9,496
Deferred income taxes	-	414	849
Change in operating accounts, net of effect from acquisitions:			
Accounts receivable	(1,473)	20,043	(6,516)
Income tax receivable	7,612	(5,421)	(1,892)
Inventories	60	(97)	(167)
Prepaid expenses and other assets	268	58	259
Accounts payable and accrued liabilities	(2,259)	(2,355)	(949)
Net cash provided by (used in) operating activities	<u>(12,805)</u>	<u>(13,547)</u>	<u>24,744</u>
<b>Investing activities:</b>			
Acquisitions, net of cash received	-	-	(532)
Capital expenditures	(322)	(13,431)	(6,312)
Sale (purchase) of short-term investments	25,196	16,172	(23,418)
Net cash provided by (used in) investing activities	<u>24,874</u>	<u>2,741</u>	<u>(30,262)</u>
<b>Financing activities:</b>			
Tax benefits from stock-based compensation	-	-	1,543
Cash received from stock sale for employee stock purchase plan	66	413	-
Cash received from exercise of stock options	16	12	7,254
Repurchase of common stock	(753)	-	-
Net cash provided by (used in) financing activities	<u>(671)</u>	<u>425</u>	<u>8,797</u>
Net increase (decrease) in cash and cash equivalents	11,398	(10,381)	3,279
Cash and cash equivalents, beginning of period	7,475	17,856	14,577
Cash and cash equivalents, end of period	<u>\$ 18,873</u>	<u>\$ 7,475</u>	<u>\$ 17,856</u>
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid for income taxes	<u>\$ 257</u>	<u>\$ 700</u>	<u>\$ 5,776</u>

See accompanying notes to the consolidated financial statements.



**SMITH MICRO SOFTWARE, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## **1. Organization, Basis of Presentation and Summary of Significant Accounting Policies**

### *The Company*

Smith Micro Software, Inc. provides software and services that simplify, secure and enhance the mobile experience. The Company's portfolio of wireless software products includes a wide range of client and server applications that manage voice and data communications and connectivity across 3G, 4G and Wi-Fi networks. We sell these products and services to many of the world's leading mobile network operators, original equipment manufacturers ("OEM"), device manufacturers and enterprise businesses. The proliferation of mobile broadband technology is providing new opportunities for our products and services on a global basis. When broadband network technologies, such as EVDO, UMTS/HSPA, Wi-Fi, LTE and WiMAX, are combined with new mobile devices such as Smartphones, Tablet computers, Netbooks and emerging Machine-to-Machine ("M2M") devices, many new challenges emerge in the areas of connectivity, reliability, security, performance, cost of ownership, and ease-of-use. Our core technologies are designed to address these emerging mobile challenges, helping our customers to save money while capitalizing on new revenue opportunities.

Our products operate on a wide range of device platforms, including Windows, Mac, UNIX, Linux, iOS, Android, Windows Mobile, Symbian and Java platforms. Our patented compression technologies are utilized within various Smith Micro enterprise and consumer products, providing efficient data delivery and storage across a number of platforms. In addition to our wireless and mobility software, our innovative line of productivity and graphics products is distributed through a variety of consumer channels worldwide, our online stores, and third-party wholesalers, retailers and value-added resellers.

The underlying philosophy common to all of our products is our desire to improve the user experience and optimize resources for our customers. These objectives are delivered through the combination of quality engineering, standards-based innovation, and unmatched software integration expertise. We have over 30 years of experience in the design, engineering, and commercial deployment of mobile software products around the world.

### *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.

### *Foreign Currency Transactions*

The Company has international operations resulting from acquisitions over the past several years. The countries in which the Company has a subsidiary or branch office in are Hong Kong, Serbia, the United Kingdom and Canada. The functional currency for all of these foreign entities is the U.S. dollar in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic No. 830-30, Foreign Currency Matters-Translation of Financial Statements. Foreign currency transactions that increase or decrease expected functional currency cash flows is a foreign currency transaction gain or loss that are included in determining net income for the period in which the exchange rate changes. Likewise, a transaction gain or loss

(measured from the transaction date or the most recent intervening balance sheet date, whichever is later) realized upon settlement of a foreign currency transaction is included in determining net income for the period in which the transaction is settled.

### ***Use of Estimates***

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

### ***Fair Value of Financial Instruments***

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

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

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

- Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 - Unobservable inputs which are supported by little or no market activity.

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

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

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

### ***Significant Concentrations***

For the year ended December 31, 2012, two customers, each accounting for over 10% of revenues, made up 61.2% of revenues and 78% of accounts receivable, and three suppliers, each with more than 10% of inventory purchases, totaled 1% of accounts payable. For the year ended December 31, 2011, three customers, each accounting for over 10% of revenues, made up 54.9% of revenues and

63% of accounts receivable, and four suppliers, each with more than 10% of inventory purchases, totaled 4% of accounts payable. For the year ended December 31, 2010, three customers, each accounting for over 10% of revenues, made up 66.3% of revenues and 78% of accounts receivable, and five suppliers, each with more than 10% of inventory purchases, totaled 5% of accounts payable.

### ***Cash and Cash Equivalents***

Cash and cash equivalents generally consist of cash, government securities, mutual funds, and money market funds. These securities are primarily held in two financial institutions and are uninsured except for the minimum Federal Deposit Insurance Corporation (“FDIC”) coverage, and have original maturity dates of three months or less. As of December 31, 2012 and 2011, bank balances totaling approximately \$9.1 million and \$3.3 million, respectively, were uninsured. As of January 1, 2013, the Dodd-Frank Deposit Insurance Provision which provided insurance on substantially all deposits held in non-interest bearing transaction accounts, expired. Had this provision expired at year-end, our uninsured bank balance would have been approximately \$18.6 million at December 31, 2012.

### ***Short-Term Investments***

Short-term investments consist of corporate notes, bonds, and commercial paper and U.S. government agency and government sponsored enterprise obligations. The Company accounts for these short-term investments as required by FASB ASC Topic No. 320, Investments-Debt and Equity Securities. These debt and equity securities are not classified as either held-to-maturity securities or trading securities. As such, they are classified as available-for-sale securities. Available-for-sale securities are recorded at fair value, with unrealized gains or losses recorded as a separate component of accumulated other comprehensive income in stockholders’ equity until realized.

### ***Accounts Receivable and Allowance for Doubtful Accounts***

We sell our products worldwide. We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history, the customer’s current credit worthiness and various other factors, as determined by our review of their current credit information. We continuously monitor collections and payments from our customers. We estimate credit losses and maintain an allowance for doubtful accounts reserve based upon these estimates. While such credit losses have historically been within our estimated reserves, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past. If not, this could have an adverse effect on our consolidated financial statements. 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 compact disks (“CDs”), boxes and manuals and are stated at the lower of cost (determined by the first-in, first-out method) or market. The Company regularly reviews its inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on management’s forecast of product demand and production requirements. At December 31, 2012, our net inventory balance of \$0.2 million consisted of \$0.1 million of assembled products and \$0.1 million of components. At December 31, 2011, our net inventory balance of \$0.3 million consisted of \$0.2 million of assembled products and \$0.1 million of components.

### ***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.

### ***Internal 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, 2012, software has been substantially completed concurrently with the establishment of technological feasibility; accordingly, no costs have been capitalized to date.

### ***Impairment of Goodwill and Long-Lived Assets***

During the period ended September 30, 2011, the Company concluded that a decline in its stock price and market capitalization was representative of the fair value of the reporting unit as a whole.

The triggering events that led us to this conclusion were:

- Revenues - declined for the third consecutive quarter.
- New product launches – although we were in trials for several of our new products, as of September 30, 2011 we had not realized any revenues from these new products.
- Profitability – declined for the third consecutive quarter.
- Stock price – remained at depressed prices.

As such, the Company performed Step 1 of the goodwill impairment test which failed, triggering Step 2. As a result of this analysis, the excess of the carrying value of goodwill was compared to the implied fair value of goodwill and resulted in an impairment loss of \$94.2 million in the fiscal quarter ended September 30, 2011.

As a result of the triggering events described above in our goodwill impairment analysis, the Company reviewed its long-lived assets for recoverability. As a result of this analysis, the Company recognized a long-lived asset impairment charge of \$18.7 million in the fiscal quarter ended September 30, 2011 which was allocated pro-rata to the intangible assets of \$13.4 million and \$5.3 million to equipment and improvements, primarily related to our leasehold improvements.

As a result of the \$112.9 million goodwill and long-lived asset impairment charge recorded in the fiscal quarter ended September 30, 2011, there were no more goodwill or intangible assets on the balance sheet as of that date.

### ***Deferred Rent and Other Long-Term Liabilities***

The long-term liabilities are for deferred rent to account for the difference between straight-line and bargain rents, lease incentives included in deferred rent, the Pennsylvania Opportunity Grant liability and deferred revenue beyond one year.

## ***Revenue Recognition***

We currently report our net revenues under two operating groups: Wireless and Productivity & Graphics. Within each of these groups software revenue is recognized based on the customer and contract type. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectability is probable as required by FASB ASC Topic No. 985-605, Software-Revenue Recognition. We recognize revenues from sales of our software to our customers or end users as completed products are shipped and title passes; or from royalties generated as authorized customers duplicate our software, if the other requirements are met. If the requirements are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. For Wireless sales, returns from customers are limited to defective goods or goods shipped in error. Historically, customer returns have not exceeded the very nominal estimates and reserves. We also provide some technical support to our customers. Such costs have historically been insignificant.

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

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

## ***Sales Incentives***

For our Productivity & Graphics sales, 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 as required by FASB ASC Topic No. 985-605, Software-Revenue Recognition. We use historical redemption rates to estimate the cost of customer incentives. Total sales incentives were \$0.9 million, \$1.2 million and \$2.0 million for the years ended December 31, 2012, 2011 and 2010, respectively.

### Advertising Expense

Advertising costs are expensed as incurred. Advertising expenses were \$0.6 million, \$0.7 million, and \$0.9 million for the years ended December 31, 2012, 2011 and 2010, respectively.

### Stock-Based Compensation

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

### Net Income (Loss) Per Share

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

	Year Ended December 31,		
	2012	2011	2010
	(in thousands, except per share amounts)		
<b>Numerator:</b>			
Net income (loss) available to common stockholders	<u>(\$25,463)</u>	<u>(\$159,606)</u>	<u>\$12,346</u>
<b>Denominator:</b>			
Weighted average shares outstanding - basic	35,849	35,617	34,204
Potential common shares - options (treasury stock method)	<u>-</u>	<u>-</u>	<u>411</u>
Weighted average shares outstanding - diluted	<u>35,849</u>	<u>35,617</u>	<u>34,615</u>
Shares excluded (anti-dilutive)	<u>174</u>	<u>126</u>	<u>-</u>
Shares excluded due to an exercise price greater than weighted average stock price for the period	<u>1,453</u>	<u>1,561</u>	<u>1,950</u>
Net income (loss) per common share:			
Basic	<u>(\$0.71)</u>	<u>(\$4.48)</u>	<u>\$0.36</u>
Diluted	<u>(\$0.71)</u>	<u>(\$4.48)</u>	<u>\$0.36</u>

### Recent Accounting Pronouncements

In December 2011, the FASB issued Accounting Standards Update (“ASU”) No. 2011-12, *Comprehensive Income (Topic 220)*. The amendments in this Update supersede certain pending paragraphs in ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, to effectively defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. The amendments will be temporary to allow the Board time to redeliberate the presentation requirements

for reclassifications out of accumulated other comprehensive income for annual and interim financial statements for public, private, and non-profit entities.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. Under the amendments to this Update, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company has implemented this guidance.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurements and Disclosures (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. The Company has implemented this guidance and its adoption has not had an impact on its consolidated results of operations and financial condition.

## 2. Fair Value of Contingent Liability

When we acquired Core Mobility in October 2009, we set up a pre-acquisition contingency for two milestone payments that were part of the purchase price of the business. The first milestone payment of \$0.6 million was met and paid in March 2010. The second milestone payment of \$1.2 million was not met and therefore not paid. The Core Mobility shareholders disputed this claim in a lawsuit which was settled in August 2012, when the plaintiffs chose not to appeal our court victory.

As a result of the litigation victory, we were no longer liable to pay this second milestone payment and the \$1.2 million contingent liability was returned to profit as required by FASB ASC Topic No. 805, Business Combinations. In accordance with FASB ASC Topic No. 820, Fair Value Measurement, the fair value of this contingent liability became zero once it was determined that we did not have to pay it. The fair value of this contingent liability is as follows (in thousands):

<u>Description</u>	<u>Period Ended</u> <u>December 31, 2012</u>	<u>Fair Value Measurements Using</u>			<u>Total</u> <u>Gains</u>
		<u>Quoted Prices</u> <u>in Active</u> <u>Markets for</u> <u>Identical Assets</u> <u>(Level 1)</u>	<u>Significant</u> <u>Other</u> <u>Observable</u> <u>Inputs</u> <u>(Level 2)</u>	<u>Significant</u> <u>Unobservable</u> <u>Inputs</u> <u>(Level 3)</u>	
Contingent liability	\$ -	\$ -	\$ -	\$ -	<u>\$1,210</u>

## 3. Restructuring

In July 2011, we announced that our Chicago facility would be permanently closed as of September 30, 2011 and resulted in charges of \$1.0 million recorded in the third quarter of fiscal year 2011. In October 2011, we announced a material Restructuring Plan that was approved by our Board of Directors resulting in charges of \$2.2 million in the fourth quarter of fiscal year 2011. This Restructuring Plan involved a realignment of organizational structures, facility consolidations/closures and headcount reductions that amounted to approximately 20% of the Company's worldwide workforce. The Restructuring Plan was implemented primarily during the fourth quarter of the Company's 2011 fiscal year. Of the total charges, all but approximately \$0.4 million were cash expenditures.

The following is the activity in our restructuring liability account which is included in accrued liabilities line item on the balance sheet for the year ended December 31, 2011 (in thousands):

	December 31, 2010				December 31, 2011	
	<u>Balance</u>	<u>Provision</u>	<u>Usage</u>	<u>Reclass</u>	<u>Balance</u>	
One-time employee termination benefits	\$ -	\$ 2,230	\$ (1,129)	\$ -	\$ 1,101	
Lease/rental terminations	-	558	(110)		448	
Relocation, move, other expenses	-	396	(284)	4	116	
Total	\$ -	\$ 3,184	\$ (1,523)	\$ 4	\$ 1,665	

In February 2012, we undertook an additional Restructuring Plan that included a further reduction of headcount of 7-8% and other cost reductions that would result in annualized savings of approximately \$7.0 million. One-time employee termination and other costs resulted in additional restructuring expenses of \$0.2 million was recorded in year ended December 31, 2012.

The following is the activity in our restructuring liability account which is included in the accrued liabilities line item on the balance sheet for the period ended December 31, 2012 (in thousands):

	December 31, 2011			December 31, 2012	
	<u>Balance</u>	<u>Provision-net</u>	<u>Usage</u>	<u>Balance</u>	
One-time employee termination benefits	\$ 1,101	\$ 145	\$ (1,238)	\$ 8	
Lease/rental terminations	448	(12)	(436)	-	
Relocation, move, other expenses	116	105	(221)	-	
Total	\$ 1,665	\$ 238	\$ (1,895)	\$ 8	

## 4. Balance Sheet Details

### *Short-Term Investments*

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

	December 31, 2012			December 31, 2011		
	<u>Amortized</u>	<u>Gross</u>		<u>Amortized</u>	<u>Gross</u>	
	<u>cost basis</u>	<u>unrealized loss</u>	<u>Fair value</u>	<u>cost basis</u>	<u>unrealized loss</u>	<u>Fair value</u>
Corporate notes, bonds and paper	\$ 9,091	\$ (7)	\$ 9,084	\$ 31,217	\$ (37)	\$ 31,180
Government securities/money market	4,245	(1)	4,244	7,321	(4)	7,317
Total	\$ 13,336	\$ (8)	\$ 13,328	\$ 38,538	\$ (41)	\$ 38,497

There was a de minimis amount of realized gains recognized for the year ended December 31 2012. There were no realized gains (losses) recognized in interest and other income for the years ended December 31, 2011 and 2010.



### ***Equipment and Improvements***

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

	<b>December 31,</b>	
	<b>2012</b>	<b>2011</b>
Computer hardware, software, and equipment	\$ 16,122	\$ 16,277
Leasehold improvements	6,368	6,283
Office furniture and fixtures	1,611	1,712
	<u>24,101</u>	<u>24,272</u>
Less accumulated depreciation and amortization	(12,890)	(8,790)
Equipment and improvements, net	<u>\$ 11,211</u>	<u>\$ 15,482</u>

Depreciation and amortization expense on equipment and improvements was \$4.4 million, \$4.1 million and \$2.9 million for the years ended December 31, 2012, 2011 and 2010 respectively.

### ***Other Assets***

These are office rent deposits.

### ***Accrued Liabilities***

Accrued liabilities consist of the following (in thousands):

	<b>December 31,</b>	
	<b>2012</b>	<b>2011</b>
Salaries and benefits	\$ 4,061	\$ 4,417
Restructuring	8	1,665
Earnouts/holdbacks	-	1,210
Royalties and revenue sharing	544	326
Income taxes	167	(53)
Marketing expenses, rebates and other	49	76
Total accrued liabilities	<u>\$ 4,829</u>	<u>\$ 7,641</u>

## **5. Income Taxes**

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

	<b>Year Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
<b>Current:</b>			
Federal	\$ 50	\$ (6,844)	\$ 3,071
State	(440)	190	652
Foreign	156	311	54
<b>Total current</b>	<b>(234)</b>	<b>(6,343)</b>	<b>3,777</b>
<b>Deferred:</b>			
Federal	-	(873)	943
State	-	1,713	(82)
Excess tax benefits related to stock based compensation	-	-	1,543
Tax deficiencies related to restricted stock expense	-	(426)	(15)
Other adjustments	-	-	(1)
<b>Total deferred</b>	<b>-</b>	<b>414</b>	<b>2,388</b>
<b>Total provision</b>	<b>\$ (234)</b>	<b>\$ (5,929)</b>	<b>\$ 6,165</b>

A reconciliation of the provision for income taxes to the amount of income tax expense that would result from applying the federal statutory rate to the profit before income taxes is as follows:

	<b>Year Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
Federal statutory rate	35 %	35 %	35 %
State tax, net of federal benefit	3	4	5
Equity compensation	(2)	-	3
R&D tax credit	-	-	(5)
Goodwill impairment	-	(5)	-
Other	(4)	-	(5)
Change in valuation allowance	(31)	(30)	-
	<b>1 %</b>	<b>4 %</b>	<b>33 %</b>

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

	Year Ended December 31,	
	2012	2011
<b>Current</b>		
Various reserves	\$ 199	\$ 369
Nondeductible accruals	1,352	1,661
Prepaid expenses	(95)	(96)
Other	43	25
Valuation allowance	(1,410)	(1,951)
Total Current	<u>\$ 89</u>	<u>\$ 8</u>
<b>Non-current</b>		
Credit carryforwards	3,708	4,223
Net operating loss carryforwards	23,808	11,286
Fixed assets	1,299	1,695
Amortization	31,483	35,252
Identifiable intangibles acquired	(2,239)	(2,288)
Equity based compensation	934	978
Other	24	83
Valuation allowance	(59,108)	(51,239)
Total Non-current	<u>\$ (91)</u>	<u>\$ (10)</u>

The Company has federal and state net operating loss carryforwards of approximately \$55.0 million and \$83.4 million, respectively, at December 31, 2012, to reduce future cash payments for income taxes. Of the \$55.0 million of NOL carryforwards at December 31, 2012, \$0.5 million relates to the excess tax benefits from employee restricted stock. Equity will be increased by \$0.5 million if and when such excess tax benefits are ultimately realized. These federal net operating loss carryforwards will expire from 2024 through 2031 and state net operating loss carryforwards will expire 2015 through 2031. The Company also had \$0.5 million of AMT credit carryforwards with an indefinite life, available to offset regular federal income tax requirements.

The Company has federal and state tax credit carryforwards of approximately \$3.4 million and \$0.7 million, respectively, at December 31, 2012. These tax credits will begin to expire in 2027.

At December 31, 2012 and 2011, respectively, the Company had unrecognized tax benefits of approximately \$0.6 million and \$0.3 million, including interest and penalties, respectively.

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

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. A significant factor in the Company’s assessment is that the Company was in a three-year historical cumulative loss as of the end of fiscal 2011. This fact, combined with uncertain near-term market and economic conditions, reduced the Company’s ability to rely on projections of future taxable income in assessing the realizability of its deferred tax assets.

After a review of the four sources of taxable income as of December 31, 2011 (as described above), and after consideration of the Company’s three-year cumulative loss position as of December 31, 2011, the

Company recorded a valuation allowance related to its U.S.-based deferred tax amounts, with a corresponding charge to income tax expense, of \$53.2 million during the year ended December 31, 2011.

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

In 2007, the Company adopted FASB ASC Topic 740, "Income Taxes," which clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. Management determined based on its evaluation of the Company's income tax positions that it has uncertain tax positions relating to research and development ("R&D") tax credits of \$0.6 million at December 31, 2012 and \$0.3 million at December 31, 2011 for which the Company has not yet recognized an income tax benefit for financial reporting purposes. Assuming these tax benefits had been recognized as of December 31, 2012, such benefit would have been fully negated by a corresponding increase in the deferred income tax valuation allowance because the Company has recorded a full valuation allowance against its recognized R&D tax credits of \$3.0 million due to uncertainty as to future realization.

The Company's gross unrecognized tax benefits as of December 31, 2012 and the changes in those balances are as follows (in thousands):

	Year Ended December 31,	
	2012	2011
Beginning Balance	\$ 324	\$ -
Increases for tax positions for current year	-	162
Increases/(Decreases) in tax positions for the prior year	268	162
Lapse in statute of limitations	-	-
Settlements	-	-
Other	-	-
Change in valuation allowance	-	-
Gross Unrecognized tax benefits, ending balance	\$ 592	\$ 324

We recognized interest and penalties accrued related to unrecognized tax benefits in tax expense. During the fiscal year 2012, we recognized approximately \$38,000 in interest and penalties. We did not recognize any interest and penalties in fiscal year 2011.

The Company is subject to U.S. federal income tax as well as to income tax of multiple state jurisdictions. Federal income tax returns of the Company are subject to IRS examination for the 2009 through 2011 tax years. State income tax returns are subject to examination for a period of three to four years after filing. The Company closed an examination by the Internal Revenue Service ("IRS") for the 2008 tax year in 2012 with no changes. As of December 31, 2012, the Company has been notified of audits with Illinois, New York, and Texas. These audits are anticipated to begin in 2013. The outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. As of December 31, 2012, a current estimate of the range

of changes that may occur within the next twelve months cannot be made due to the uncertainty regarding the timing of these events.

## 6. Commitments and Contingencies

### *Leases*

The Company leases its buildings under operating leases that expire on various dates through 2022. Future minimum annual lease payments under such leases as of December 31, 2012 are as follows (in thousands):

<u>Year Ending December 31,</u>	<u>Operating</u>
2013	\$ 2,611
2014	2,606
2015	2,424
2016	2,128
2017	1,787
Beyond	6,314
Total	<u>\$ 17,870</u>

Total rent expense was \$2.7 million, \$2.8 million and \$2.5 million for the years ended December 31, 2012, 2011 and 2010, respectively.

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

### *Pennsylvania Opportunity Grant Program*

On September 26, 2011, we received \$1.0 million from the State of Pennsylvania to help fund our agreement to start-up a new facility. The grant carries with it an obligation, or commitment, to employ at least 232 people within a three-year time period. This grant contains conditions that would require us to return a pro-rata amount of the monies received if we fail to meet these conditions. As such, the monies have been recorded as a liability in the Deferred rent and other long-term liabilities line item on the balance sheet until we are irrevocably entitled to retain the monies.

### *Litigation*

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

### *Other Contingent Contractual Obligations*

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include: intellectual property indemnities to the Company's customers and licensees in connection with the use, sale and/or license of Company products; indemnities to various lessors in

connection with facility leases for certain claims arising from such facility or lease; indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct of the Company; indemnities involving the accuracy of representations and warranties in certain contracts; and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware. In addition, the Company has made contractual commitments to employees providing for severance payments upon the occurrence of certain prescribed events. The Company may also issue a guarantee in the form of a standby letter of credit as security for contingent liabilities under certain customer contracts. The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees may not provide for any limitation of the maximum potential for future payments the Company could be obligated to make. The Company has not recorded any liability for these indemnities, commitments and guarantees in the accompanying consolidated balance sheets.

## 7. Segment, Customer Concentration and Geographical Information

### *Segment Information*

Public companies are required to report financial and descriptive information about their reportable operating segments as required by FASB ASC Topic No. 280, Segment Reporting. The Company has two primary business units based on how management internally evaluates separate financial information, business activities and management responsibility. Wireless includes our QuickLink, NetWise and CommSuite family of products. Productivity & Graphics includes our consumer-based products: Poser, Anime Studio, Manga Studio, MotionArtist and StuffIt. “Corporate/Other” revenue includes the consulting portion of our services sector which has been de-emphasized and is not a strategic element of our future plans.

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

	Year Ended December 31,		
	2012	2011	2010
Wireless	\$ 36,963	\$ 48,711	\$ 118,684
Productivity & Graphics	6,175	8,816	11,399
Corporate/Other	191	240	418
Total revenues	43,329	57,767	130,501
Cost of revenues	8,448	13,761	15,507
Gross profit	\$ 34,881	\$ 44,006	\$ 114,994

### *Customer Concentration Information*

Revenues to two customers (Sprint and Verizon Wireless) and their respective affiliates in the Wireless business segment accounted for 40.7% and 20.5%, respectively, of the Company’s total revenues for the fiscal year 2012. In 2011, our three largest customers (Sprint, Verizon Wireless and AT&T) accounted for 24.8%, 18.4% and 11.7%, respectively, of our total revenues. In 2010, our three largest customers (Verizon Wireless, Sprint and AT&T) accounted for 40.1%, 13.9% and 12.3%, respectively, of our total revenues. 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 customers or decisions by a significant customer to substantially reduce purchases could have a material adverse effect on our business.

## ***Geographical Information***

During the years ended December 31, 2012, 2011 and 2010, the Company operated in three geographic locations: the Americas, Asia Pacific and EMEA (Europe, the Middle East, and Africa). Revenues attributed to the geographic location of the customer's bill-to address, were as follows (in thousands):

	<b>Year ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
Americas	\$ 37,724	\$ 51,784	\$ 121,495
Asia Pacific	2,871	2,812	1,889
EMEA	2,734	3,171	7,117
Total revenues	<u>\$ 43,329</u>	<u>\$ 57,767</u>	<u>\$ 130,501</u>

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

## **8. 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 \$0.3 million, \$0.5 million and \$0.6 million for the years ended December 31, 2012, 2011 and 2010, respectively.

## **9. Stock-Based Compensation**

### ***Stock Plans***

On July 28, 2005, our Shareholders approved the 2005 Stock Option / Stock Issuance Plan ("2005 Plan"). The 2005 Plan, which became effective the same date, replaced the 1995 Stock Option / Stock Issuance Plan ("1995 Plan"), which expired on May 24, 2005. All outstanding options under the 1995 Plan remained outstanding, but no further grants will be made under that Plan.

The 2005 Plan provides for the issuance of non-qualified or incentive stock options and restricted stock to employees, non-employee members of the board and consultants. The exercise price per share for option grants is not to be less than the fair market value per share of the Company's common stock on the date of grant. The Board of Directors has the discretion to determine the vesting schedule. Options may be exercisable immediately or in installments, but generally vest over a four-year period from the date of grant. In the event the holder ceases to be employed by the Company, all unvested options terminate and all vested options may be exercised within a period following termination. In general, options expire ten years from the date of grant. Restricted stock is valued using the closing stock price on the date of the grant. The total value is expensed over the vesting period of 12 to 48 months. The maximum number of shares of the Company's common stock that were available for issuance over the term of the original 2005 Plan previously could not exceed 5,000,000 shares, plus additional shares equal to 2.5% of the number of shares of common stock outstanding on the last trading day of the calendar year commencing with calendar year 2006, but not in excess of 750,000 shares. On October 11, 2007, our shareholders voted to approve an amendment to the 2005 Plan to increase the maximum number of shares of common stock that may be issued under the 2005 Plan from 5,000,000 shares (plus an annual increase) to 7,000,000 shares (plus an annual increase).

### ***Employee Stock Purchase Plan***

The Company has a shareholder approved employee stock purchase plan ("ESPP"), under which substantially all employees may purchase the Company's common stock through payroll deductions

at a price equal to 85% of the lower of the fair market values of the stock as of the beginning and end of six-month offering periods. An employee's payroll deductions under the ESPP are limited to 10% of the employee's compensation and employees may not purchase more than the lesser of \$25,000 of stock, or 1,000 shares, for any calendar year. Additionally, no more than 1,000,000 shares may be purchased under the plan.

### ***Stock Compensation Expense***

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

### ***Valuation of Stock Option and Restricted Stock Awards***

The assumptions used to compute the share-based compensation costs for the stock options granted during the years ended December 31, 2012, 2011 and 2010, respectively, using the Black-Scholes option pricing model, were as follows:

	<b>Year Ended December 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>2010</b>
Weighted average grant-date fair value of stock options	\$0.80	\$1.16	\$2.97
<b><i>Assumptions</i></b>			
Risk-free interest rate (weighted average)	0.5%	0.2%	0.3%
Expected dividend yield	-	-	-
Weighted average expected life (years)	4	1	1
Volatility (weighted average)	80.0%	73.0%	72.0%
Forfeiture rate	13.7%	-	-

The risk-free interest rate assumption was based on the United States Treasury's rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award being valued. The Company assumed no dividend yield because it does not expect to pay dividends for the foreseeable future. The weighted average expected life is the vesting period for those options granted during that period. The average volatility is based on the actual historical volatility of our common stock. The forfeiture rate was based on modified employee turnover.

Grants of restricted stock are valued using the closing stock price on the date of grant. In the year ended December 31, 2012, a total of 40,000 shares of restricted stock, with a total value of \$0.1 million, were granted to non-employee members of the Board of Directors. This cost will be amortized over a period of 12 months. In addition, 1.0 million shares of restricted stock, with a total value of \$2.5 million, were granted to key officers and employees of the Company. This cost will be amortized over a period of 48 months.

### ***Valuation of ESPP***

The fair values are estimated at the beginning of each offering period using a Black-Scholes valuation model that uses the assumptions noted in the following table. The risk-free rate is based on the U.S. treasury yield curve in effect at the time of grant. Expected volatility was based on the historical volatility on the day of grant. Following is a schedule of the shares purchased, the fair value per share, and the Black-Scholes model assumptions for each offering period:



Offering Period Ended	(Ending)				
	March 31,	September 31,	March 31,	September 31,	March 31,
	2013	2012	2012	2011	2011
Shares purchased for offering period	-	8,052	44,666	52,762	43,335
Fair value per share	\$0.65	\$0.93	\$0.69	\$3.61	\$3.98
<b>Assumptions</b>					
Risk-free interest rate (average)	0.14%	0.14%	0.50%	0.12%	0.18%
Expected dividend yield	-	-	-	-	-
Weighted average expected life (years)	0.5	0.5	0.5	0.5	0.5
Volatility (average)	74.0%	78.0%	105.0%	72.0%	72.0%

### Compensation Costs

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

	Year Ended December 31,		
	2012	2011	2010
Cost of revenues	\$ 13	\$ 31	\$ 101
Selling and marketing	865	1,922	2,529
Research and development	765	1,198	2,505
General and administrative	2,306	3,379	4,361
Total non-cash stock compensation expense	\$ 3,949	\$ 6,530	\$ 9,496

Total share-based compensation for each year includes cash payment of income taxes related to grants of restricted stock in the amounts of \$0.4 million, \$1.5 million and \$2.1 million for the years ended December 31, 2012, 2011 and 2010, respectively.

### Stock Options

A summary of the Company's stock options outstanding under the 2005 Plan as of December 31, 2012 and the activity during the years ended herein are as follows (in thousands except per share amounts):

	Shares	Weighted Ave. Exercise Price	Aggregate Intrinsic Value
<b>Outstanding as of December 31, 2009</b>	<b>3,536</b>	<b>\$ 11.29</b>	
(2,754 options exercisable at a weighted average exercise price of \$10.55)			
Granted (weighted average fair value of \$2.97)	20	\$ 10.51	
Exercised	(760)	\$ 9.55	
Cancelled	(90)	\$ 13.80	
<b>Outstanding as of December 31, 2010</b>	<b>2,706</b>	<b>\$ 11.69</b>	<b>\$ -</b>
(2,545 options exercisable at a weighted average exercise price of \$11.54)			
Granted (weighted average fair value of \$1.16)	25	\$ 4.07	
Exercised	(7)	\$ 1.77	
Cancelled	(557)	\$ 14.04	
<b>Outstanding as of December 31, 2011</b>	<b>2,167</b>	<b>\$ 11.03</b>	<b>\$ -</b>
(2,167 options exercisable at a weighted average exercise price of \$11.03)			
Granted (weighted average fair value of \$0.80)	826	\$ 1.39	
Exercised	(32)	\$ 0.50	
Cancelled	(686)	\$ 12.37	
<b>Outstanding as of December 31, 2012</b>	<b>2,275</b>	<b>\$ 7.02</b>	<b>\$ -</b>
Exercisable as of December 31, 2012	1,474	\$ 10.09	\$ -
Vested and expected to vest at December 31, 2012	2,171	\$ 7.29	\$ -

During the year ended December 31, 2012, options to acquire 32,000 shares with an intrinsic value of \$33,000 were exercised resulting in cash proceeds to the Company of \$16,000. The weighted-average grant-date fair value of options granted during the year ended December 31, 2012 was \$0.80. As of December 31, 2012, there is \$6.3 million of unrecognized compensation costs related to non-vested stock options and restricted stock granted under the Plan. At December 31, 2012, there were 2.3 million shares available for future grants under the 2005 Stock Issuance / Stock Option Plan.

### **Restricted Stock Awards**

A summary of the Company's restricted stock awards outstanding under the 2005 Plan as of December 31, 2012, and the activity during years ended therein, are as follows (in thousands):

	Number of shares	Weighted average grant date fair value
Unvested at December 31, 2009	1,415	\$ 6.28
Granted	933	\$ 8.27
Vested	(679)	\$ 6.50
Cancelled and forfeited	(65)	\$ 9.25
Unvested at December 31, 2010	1,604	\$ 7.23
Granted	1,000	\$ 8.86
Vested	(823)	\$ 7.40
Cancelled and forfeited	(426)	\$ 7.81
Unvested at December 31, 2011	1,355	\$ 3.21
Granted	995	\$ 2.64
Vested	(611)	\$ 6.42
Cancelled and forfeited	(420)	\$ 8.73
Unvested at December 31, 2012	1,319	\$ 4.60

## **10. Stock Repurchase Program**

In November 2011, the Company announced that its Board of Directors had approved a program authorizing the repurchase of up to five million shares of the Company's common stock over a period of up to two years. Under this program, stock repurchases may be made from time to time and the actual amount expended will depend on a variety of factors including market conditions, regulatory and legal requirements, corporate cash generation and other factors. The stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of Rule 10b5-1 trading plans. The program does not obligate Smith Micro to repurchase any particular amount of common stock during any period and the program may be modified or suspended at any time at the Company's discretion. The Company did not repurchase any shares in fiscal year 2011. The Company repurchased 375,000 shares at a cost of \$0.8 million during fiscal year 2012.

## **11. Subsequent Events**

In May 2009, the FASB issued new accounting guidance found under ASC Topic No. 855, Subsequent Events. The Topic establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued

Subsequent events have been evaluated as of the date of this filing and there are no further disclosures required.

## 12. Quarterly Financial Data (Unaudited)

The following financial information reflects all normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of the results of the interim periods. Summarized quarterly data for fiscal 2012 and 2011 are as follows (in thousands, except per share data):

	Year ended December 31, 2012			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
<b>Selected quarterly financial data:</b>				
Revenues	\$ 10,114	\$ 10,171	\$ 11,012	\$ 12,032
Gross profit	\$ 7,919	\$ 8,375	\$ 8,892	\$ 9,695
Operating (loss)	\$ (9,615)	\$ (6,824)	\$ (6,007)	\$ (4,555)
Net (loss)	\$ (9,682)	\$ (6,825)	\$ (4,813)	\$ (4,143)
Net (loss) per share, basic (1)	\$ (0.27)	\$ (0.19)	\$ (0.13)	\$ (0.12)
Weighted average shares outstanding, basic	35,590	36,045	35,879	35,882
Net (loss) per share, diluted (1)	\$ (0.27)	\$ (0.19)	\$ (0.13)	\$ (0.12)
Weighted average shares outstanding, diluted	35,590	36,045	35,879	35,882
	Year ended December 31, 2011			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
<b>Selected quarterly financial data:</b>				
Revenues	\$ 17,791	\$ 16,105	\$ 12,632	\$ 11,239
Gross profit	\$ 14,015	\$ 12,545	\$ 8,933	\$ 8,513
Operating (loss)	\$ (13,012)	\$ (13,046)	\$ (127,983)	\$ (11,625)
Net (loss)	\$ (7,753)	\$ (7,847)	\$ (134,481)	\$ (9,525)
Net (loss) per share, basic (1)	\$ (0.22)	\$ (0.22)	\$ (3.76)	\$ (0.27)
Weighted average shares outstanding, basic	35,263	35,775	35,728	35,696
Net (loss) per share, diluted (1)	\$ (0.22)	\$ (0.22)	\$ (3.76)	\$ (0.27)
Weighted average shares outstanding, diluted	35,263	35,775	35,728	35,696

(1) Basic and diluted net (loss) per share is computed independently for each of the quarters presented. Therefore, the sum of the quarterly per share amounts will not necessarily equal the total for the year.

**SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS  
FOR EACH OF THE THREE YEARS  
IN THE PERIOD ENDED DECEMBER 31, 2012**

(In thousands)

	<b>Balance at beginning of period</b>	<b>Additions charged to costs and expenses</b>	<b>Deductions</b>	<b>Balance at end of period</b>
<b>Allowance for accounts receivable (1):</b>				
2012	\$ 1,382	\$ 1,045	\$ (1,945)	\$ 482
2011	855	1,244	(717)	1,382
2010	1,045	851	(1,041)	855
<b>Allowance for excess and obsolete inventory:</b>				
2012	\$ 417	\$ 73	\$ (138)	\$ 352
2011	558	158	(299)	417
2010	1,221	203	(866)	558

(1) Allowances are for retail return reserves, marketing development funds and doubtful accounts.

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**SUBSIDIARIES OF THE REGISTRANT**

1. Allume Systems, Inc., a California corporation.
2. Tag Acquisition Corporation II, a Delaware corporation.
3. E Frontier Acquisition Corporation, a Delaware corporation.
4. IS Acquisition Sub, Inc., a Delaware corporation.
5. Tel Acquisition Corporation, a Delaware corporation.
6. STF Technologies, Inc., a Missouri corporation.
7. Smith Micro Software LLC Belgrade, a Serbia corporation.
8. Smith Micro Software UK Limited, a United Kingdom corporation.
9. William W. Smith Software Canada. Ltd., a Canadian corporation.
10. Smith Micro Software, Asia Limited, a Hong Kong corporation.
11. Mobility Acquisition Corporation, a Delaware corporation.
12. Core Mobility, Inc., a Delaware corporation.

**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, 333-129132, 333-149222, 333-169671 and 333-179764) on Form S-8, Registration Statement (Nos. 333-123821, 333-128695, 333-134611, 333-137408, and 333-161658) on Form S-3 and Registration Statement (No. 333-161659) on Form S-4 of Smith Micro Software, Inc. and subsidiaries of our reports dated February 20, 2013 relating to our audits of the consolidated financial statements, the financial statement schedule, and internal control over financial reporting, which appear in this Annual Report on Form 10-K of Smith Micro Software, Inc. and subsidiaries for the year ended December 31, 2012.

/s/ SINGERLEWAK LLP  
Los Angeles, California  
February 202, 2013



## BOARD OF DIRECTORS

**William W. Smith, Jr.**  
Chairman, President &  
Chief Executive Officer

**Thomas G. Campbell**  
Director

**Gregory J. Szabo**  
Director

**Andrew Arno**  
Director

**Samuel Gulko**  
Director

## OFFICERS & SENIOR MANAGEMENT

**Von Cameron**  
Executive Vice President,  
Worldwide Sales

**Chris Lippincott**  
Senior Vice President,  
Global Operations

**Andrew C. Schmidt**  
Vice President &  
Chief Financial Officer

**Rick Carpenter**  
Senior Vice President, Engineering

**Jim Mains**  
Senior Vice President,  
Products and Programs

**David P. Sperling**  
Chief Technology Officer

**Carla Fitzgerald**  
Senior Vice President, Marketing

**Dan Rawlings**  
Chief Strategy Officer

**Steven M. Yasbek**  
Chief Accounting Officer

## CONTACT INFORMATION

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(949) 362-5800

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Canton, MA 02021  
(800) 962-4284  
[www.computershare.com](http://www.computershare.com)

**Legal Counsel**  
Loeb & Loeb LLP  
Los Angeles, CA 90067

**Auditors**  
SingerLewak  
Los Angeles, CA 90024

## ADDITIONAL INFORMATION

Smith Micro maintains an investor relations program. If you have any questions or would like additional information concerning the operations or financial statements, please contact:

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