

SMITH MICRO SOFTWARE INC

Form 10-Q

July 27, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10 Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

Commission file number 001 35525

SMITH MICRO SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

DELAWARE 33 0029027
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

51 COLUMBIA

ALISO VIEJO, CA 92656

(Address of principal executive offices, including zip code)

(949) 362-5800

(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

As of July 25, 2018, there were 25,003,420 shares of common stock outstanding.

SMITH MICRO SOFTWARE, INC.

QUARTERLY REPORT ON FORM 10-Q

June 30, 2018

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and par value data)

	June 30, 2018 (unaudited)	December 31, 2017 (audited)
Assets		
Current assets:		
Cash and cash equivalents	\$ 8,745	\$ 2,205
Accounts receivable, net of allowances for doubtful accounts and other adjustments of \$170 (2018) and \$221 (2017)	6,182	5,145
Prepaid expenses and other current assets	774	576
Total current assets	15,701	7,926
Equipment and improvements, net	1,060	1,229
Deferred tax assets, net	404	404
Other assets	148	146
Intangible assets, net	359	487
Goodwill	3,685	3,685
Total assets	\$ 21,357	\$ 13,877
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 1,315	\$ 1,333
Accrued payroll and benefits	1,998	1,994
Related-party notes payable	—	1,000
Other accrued liabilities	411	416
Deferred revenue	261	73
Total current liabilities	3,985	4,816
Non-current liabilities:		
Related-party notes payable, net of discount & issuance costs of \$0 (2018) and \$0 (2017)	1,200	1,200
Notes payable, net of discount & issuance costs of \$312 (2018) and \$442 (2017)	1,689	1,558
Warrant liability	9,004	—
Deferred rent	846	970
Other long term liabilities	649	766
Total non-current liabilities	13,388	4,494
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value \$0.001 per share; 5,000,000 shares authorized; 5,500	—	—

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shares issued (2018 and 2017); 1,370 and 5,500 shares outstanding (2018 and

2017, respectively)

Common stock, par value \$0.001 per share; 100,000,000 shares authorized;

25,003,420 and 14,268,765 shares issued and outstanding (2018 and

2017, respectively)

	25	14
Additional paid-in capital	241,790	237,486
Accumulated comprehensive deficit	(237,831)	(232,933)
Total stockholders' equity	3,984	4,567
Total liabilities and stockholders' equity	\$ 21,357	\$ 13,877

See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(in thousands, except per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018 (unaudited)	2017 (unaudited)	2018 (unaudited)	2017 (unaudited)
Revenues	\$6,945	\$ 5,862	\$12,408	\$ 11,438
Cost of revenues	1,116	1,285	2,425	2,568
Gross profit	5,829	4,577	9,983	8,870
Operating expenses:				
Selling and marketing	1,447	1,461	3,177	3,254
Research and development	2,195	2,174	4,450	4,671
General and administrative	2,061	2,239	4,251	4,428
Restructuring expense	52	322	52	714
Total operating expenses	5,755	6,196	11,930	13,067
Operating income (loss)	74	(1,619)	(1,947)	(4,197)
Other expense:				
Interest expense, net	(143)	(329)	(314)	(613)
Change in fair value of warrant liability	(2,085)	—	(2,224)	—
Other income (expense)	(10)	1	(50)	(9)
Loss before provision for income taxes	(2,164)	(1,947)	(4,535)	(4,819)
Provision for income tax expense	13	5	23	13
Net loss	\$(2,177)	\$(1,952)	\$(4,558)	\$(4,832)
Net loss per share:				
Basic and diluted	\$(0.11)	\$(0.15)	\$(0.26)	\$(0.38)
Weighted average shares outstanding:				
Basic and diluted	21,888	13,179	18,612	12,674
Preferred dividends per share	\$50.38	\$ —	\$71.16	\$ —

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the Six Months Ended June 30, 2018 2017 (unaudited)(unaudited)	
Operating activities:		
Net loss	\$(4,558)	\$ (4,832)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	407	463
Amortization of debt discounts and financing issuance costs	131	260
Provision for doubtful accounts and other adjustments to accounts receivable	(3)	74
Provision for excess and obsolete inventory	(10)	—
Gain on disposal of fixed assets	—	(6)
Stock based compensation	410	834
Change in fair value of warrant liability	2,224	—
Change in operating accounts:		
Accounts receivable	(1,034)	177
Prepaid expenses and other assets	(190)	(35)
Accounts payable and accrued liabilities	(351)	(1,252)
Deferred revenue	188	470
Net cash used in operating activities	(2,786)	(3,847)
Investing activities:		
Capital expenditures	(110)	(63)
Net cash used in investing activities	(110)	(63)
Financing activities:		
Proceeds from stock sale for employee stock purchase plan	3	2
Proceeds from common stock offering, net of expenses	10,759	2,056
Proceeds from (payments of) short-term secured promissory notes	(1,000)	2,000
Dividends paid on preferred stock	(326)	—
Net cash provided by financing activities	9,436	4,058
Net increase in cash and cash equivalents	6,540	148
Cash and cash equivalents, beginning of period	2,205	2,229
Cash and cash equivalents, end of period	\$8,745	\$ 2,377
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	\$10	\$ 5
Cash paid for interest expense	219	331
Supplemental schedule of non-cash financing activities:		
Issuance of common stock warrants in connection with stock offering	\$6,780	\$ 64

See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.

Notes to the Consolidated Financial Statements

1. The Company

Smith Micro Software, Inc. (“Smith Micro,” “Company,” “we,” “us,” and “our”) develops software to simplify and enhance the mobile experience, providing solutions to leading wireless service providers, device manufacturers, and wireless users around the world. From optimizing wireless networks to uncovering customer experience insights, and from providing visual access to wireless voicemail to ensuring family safety, our solutions enrich connected lifestyles while creating new opportunities to engage consumers via smartphones. We also provide a services platform for the Internet of Things (“IoT”) that enables comprehensive device management and firmware over-the-air (“FOTA”) updates for various types of connected devices. Our portfolio also includes a wide range of products for creating, sharing, and monetizing rich content, such as visual messaging and 2D/3D graphics applications. With this as a focus, it is Smith Micro’s mission to help our customers thrive in a connected world.

2. Accounting Policies

Basis of Presentation

The accompanying interim consolidated balance sheet as of June 30, 2018, and the related consolidated statements of operations and comprehensive loss and cash flows for each of the three and six months ended June 30, 2018 and 2017, are unaudited. The unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (“SEC”) and, therefore, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted.

In the opinion of management, the accompanying unaudited consolidated financial statements for the periods presented reflect all adjustments which are normal and recurring, and necessary to fairly state the financial position, results of operations, and cash flows of the Company. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC on March 30, 2018 and amended April 17, 2018.

Intercompany balances and transactions have been eliminated in consolidation.

Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2018.

Recently Issued Accounting Pronouncements

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

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This updated standard supersedes nearly all existing revenue recognition guidance under the accounting principles generally accepted in the United States of America (“U.S. GAAP”). The core principle of this Topic is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. This Topic defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In July 2015, the FASB deferred the effective date of Topic 606 to annual reporting periods beginning after December 15, 2017 (including interim reporting periods within those periods). The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Company adopted the provisions of Topic 606 during the first quarter of 2018, and there was no impact on the consolidated financial statements.

Revenue Recognition

We currently report our net revenues under two operating groups: Wireless and Graphics. Generally, we recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectability is probable. We recognize revenues from sales of our software (or software that we are licensed to distribute) 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 as of the date of shipment, revenue is not recognized until these elements are known or resolved.

For Wireless, we recognize revenue using several different methods beyond the method previously mentioned. First, we provide some customers a subscription service arrangement (the “Platform”). This Platform is then deployed to their customers, the end users, either directly by the user or by the customer initiating a download of the Platform. Our service arrangement can include the use of the software application, hosting services, and maintenance and support services for the Platform. This type of arrangement is recognized on a point in time basis separately for each billing cycle (i.e. monthly or quarterly) based on the individual metrics within that period, and results in either a fixed fee per end user or a revenue sharing arrangement based on amounts received by our customers. Second, we provide other related services to some customers specific to hosting services, and maintenance and support services. These arrangements are recognized on a per period basis (i.e. typically monthly or quarterly) based on the individual arrangements agreed upon with our customers. These arrangements typically include a fixed fee for services offered within the period. Sometimes these types of services include up-front, non-refundable set-up fees. Revenue is recognized for these fees over the term of the agreement. Third, we provide a limited custom software development services under a fixed fee arrangement. This revenue is recognized based on agreed-upon deliverables and milestones – when value is provided to the customer a portion of the revenue is recognized. There are no significant judgments required for this revenue. However, we do make some estimates to accrue revenue through the fiscal quarter ends.

For Graphics, 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. Revenues 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 return period, but such returns are reasonably estimable and have historically been minimal. We also provide technical support to our customers. Such costs have historically been insignificant.

Deferred revenue represents amounts billed to customers for which revenue has not been recognized. Deferred revenue primarily consists of the unearned portion of monthly, quarterly and annually billed service fees and prepayments made by customers for a future period.

Revenues on a disaggregated basis are as follows (in thousands):

For the Three Months Ended June 30, 2018		For the Six Months Ended June 30, 2017	
	2017	2018	2017
	(unaudited)	(unaudited)	(unaudited)

Wireless: