SMITH MICRO SOFTWARE INC
Form 10-Q
May 05, 2011

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

(Mark One)

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

For the quarterly period ended March 31, 2011

OR

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

Commission file number 0-26536

SMITH MICRO SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

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

51 COLUMBIA
ALISO VIEJO, CA 92656
(Address of principal executive offices, including zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes o No þ

As of April 29, 2011 there were 35,870,291 shares of common stock outstanding.

SMITH MICRO SOFTWARE, INC.
QUARTERLY REPORT ON FORM 10-Q
March 31, 2011
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2011 (unaudited)	December 31, 2010 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 7,689	$ 17,856
Short-term investments	56,683	54,694
Accounts receivable, net of allowances for doubtful accounts and other adjustments of $774 (2011) and $855 (2010)	24,810	29,812
Income tax receivable	2,872	2,872
Inventories, net of reserves for excess and obsolete inventory of $474 (2011) and $558 (2010)	352	370
Prepaid expenses and other current assets	1,407	1,167
Deferred tax asset	1,852	2,565
Total current assets	95,665	109,336
Equipment and improvements, net	17,478	11,623
Goodwill	94,231	94,231
Intangible assets, net	17,429	19,459
Other assets	240	243
Deferred tax asset	6,253	
Total assets	$ 231,296	$ 234,892
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 7,224	$ 4,592
Accrued liabilities	8,253	8,444
Deferred revenue	438	1,667
Total current liabilities	15,915	14,703
Non-current liabilities:		
Long-term liabilities	525	197
Deferred tax liability	1,727	1,727
Total non-current liabilities	2,252	1,924
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value $0.001 per share; 5,000,000 shares authorized; none issued or outstanding		
	36	35

Common stock, par value $0.001 per share; 50,000,000 shares authorized; 35,880,291 and 34,971,108 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively		
Additional paid-in capital	204,314	201,702
Accumulated other comprehensive loss	(6)	(10)
Accumulated earnings	8,785	16,538
Total stockholders equity	213,129	218,265
Total liabilities and stockholders equity	$ 231,296	$ 234,892

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended March 31,	
	2011	2010
	(unaudited)	(unaudited)
Revenues	$ 17,791	$ 29,862
Cost of revenues	3,776	3,732
Gross profit	14,015	26,130
Operating expenses:		
Selling and marketing	8,362	7,290
Research and development	11,680	10,128
General and administrative	6,985	5,806
Total operating expenses	27,027	23,224
Operating income (loss)	(13,012)	2,906
Interest and other income	43	40
Income (loss) before taxes	(12,969)	2,946
Income tax expense (benefit)	(5,216)	1,354
Net income (loss)	$ (7,753)	$ 1,592
Net income (loss) per share:		
Basic	$ (0.22)	$ 0.05
Diluted	$ (0.22)	$ 0.05
Weighted average shares outstanding:		
Basic	35,263	33,730
Diluted	35,263	34,176

See accompanying notes to the consolidated financial statements.

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SMITH MICRO SOFTWARE, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(in thousands)

	Common stock Shares	Common stock Amount	Additional paid-in capital	Accumulated other comprehensive loss	Accumulated income	Total
BALANCE, December 31, 2010	**34,971**	**$ 35**	**$ 201,702**	**$ (10)**	**$ 16,538**	**$ 218,265**
Exercise of common stock options	6		7			7
Non cash compensation recognized on stock options and ESPP			708			708
Restricted stock grants, net of cancellations	869	1	1,398			1,399
Cancellation of shares for payment of withholding tax	(9)		(130)			(130)
Employee stock purchase plan (ESPP)	43		345			345
Excess tax benefits from stock-based compensation			284			284
Other comprehensive income (loss):						
Unrealized gain on short-term investments				4		4
Net loss					(7,753)	(7,753)
Total comprehensive loss						(7,749)
BALANCE, March 31, 2011 (unaudited)	**35,880**	**$ 36**	**$ 204,314**	**$ (6)**	**$ 8,785**	**$ 213,129**

See accompanying notes to the unaudited consolidated financial statements.

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

	Three Months Ended March 31,	
	2011 (unaudited)	2010 (unaudited)
Operating activities:		
Net income (loss)	$ (7,753)	$ 1,592
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities, net of the effect of acquisitions:		
Depreciation and amortization	2,736	2,880
Provision for doubtful accounts and other adjustments to accounts receivable	193	389
Provision for excess and obsolete inventory	26	48
Excess tax benefits from stock-based compensation	(284)	(407)
Non-cash compensation related to stock options and restricted stock	2,107	2,257
Change in operating accounts, net of effect from acquisitions:		
Accounts receivable	4,809	(2,693)
Deferred taxes	(5,540)	3
Inventories	(8)	(13)
Prepaid expenses and other assets	(237)	228
Accounts payable and accrued liabilities	1,694	616
Net cash provided by (used in) operating activities	(2,257)	4,900
Investing activities:		
Acquisitions, net of cash received		(675)
Capital expenditures	(6,561)	(1,304)
Purchase of short-term investments	(1,985)	(6,541)
Net cash used in investing activities	(8,546)	(8,520)
Financing activities:		
Excess tax benefits from stock-based compensation	284	407
Cash received from stock sale for employee stock purchase plan	345	
Cash received from exercise of stock options	7	153
Net cash provided by financing activities	636	560
Net decrease in cash and cash equivalents	(10,167)	(3,060)
Cash and cash equivalents, beginning of period	17,856	14,577
Cash and cash equivalents, end of period	$ 7,689	$ 11,517

Supplemental disclosures of cash flow information:

Cash paid for income taxes	$	224	$	49

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.
Notes to the Consolidated Financial Statements

1. The Company

Smith Micro Software, Inc. (we, us, our, Smith Micro, or the Company) designs, develops and markets softw products and services primarily for the mobile computing and communications industries. The Company is focused on developing connectivity, communications and content management solutions for a converging world of wireless and wired networks. The Company s portfolio of wireless software products and services includes a wide range of software solutions including our QuickLink® family of products. We provide mobile voice and data connectivity across 3G, 4G and Wi-Fi networks. Our mobile communications portfolio includes solutions for Push-To-Talk, Visual Voicemail, Visual Voicemail to Text, mobile device management and video. We also offer user-friendly solutions for the management of mobile content, contacts and calendar data and managed file transfers. We sell our products and services to many of the world s leading mobile network operators, original equipment manufacturers (OEM), device manufacturers and enterprise businesses, as well as directly to consumers.

2. Basis of Presentation

The accompanying interim consolidated balance sheet and statement of stockholders equity as of March 31, 2011, and the related statements of operations and cash flows for the three months ended March 31, 2011 and 2010 are unaudited. The unaudited consolidated financial statements have been prepared according to the rules and regulations of the Securities and Exchange Commission (SEC) and, therefore, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been omitted.

In the opinion of management, the accompanying unaudited consolidated financial statements for the periods presented reflect all adjustments, which are normal and recurring, necessary to fairly state the financial position, results of operations and cash flows. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed with the SEC on February 25, 2011.

Intercompany balances and transactions have been eliminated in consolidation.

Operating results for the three months ended March 31, 2011 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2011.

3. Net Income (Loss) Per Share

The Company calculates earnings per share (EPS) as required by Financial Accounting Standards Board (FASB) Accounting Standards Codification (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 periods with a net loss, the dilutive common stock equivalents are excluded from the diluted EPS calculation. For purposes of this calculation, common stock subject to repurchase by the Company and options are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

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	Three Months Ended March 31, 2011		2010	
	(unaudited, in thousands, except per share amounts)			
Numerator:				
Net income (loss) available to common stockholders	$	(7,753)	$	1,592
Denominator:				
Weighted average shares outstanding basic		35,263		33,730
Potential common shares options (treasury stock method)				446
Weighted average shares outstanding diluted		35,263		34,176
Shares excluded (anti-dilutive)		429		
Shares excluded due to an exercise price greater than weighted average stock price for the period		1,934		2,495
Net income (loss) per common share:				
Basic	$	(0.22)	$	0.05
Diluted	$	(0.22)	$	0.05

4. Stock-Based Compensation

Stock Plans

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

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

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

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

There were no stock options granted during the three months ended March 31, 2011 or March 31, 2010.

Grants of restricted stock are valued using the closing stock price on the date of grant. In the three months ended March 31, 2011, a total of 50,000 shares of restricted stock, with a total value of $0.4 million, were granted to members of the Board of Directors. This cost will be amortized over a period of 12 months. In addition, 0.9 million shares of restricted stock, with a total value of $8.1 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 Company s initial six-month offering period began on October 1, 2010. A total of 43,335 shares were purchased/granted in the offering period. The fair value of the offering was $3.98 per share and was estimated on the date of grant 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.

	Offering Period Ended March 31, 2011
Assumptions	
Risk-free interest rate (average)	.18%
Expected dividend yield	
Weighted average expected life (years)	.5
Volatility (average)	72.0%

Compensation Costs

As required by FASB ASC Topic No. 718, Compensation-Stock Compensation, the Company elected to attribute the value of stock-based compensation to expense using the straight-line method over the requisite service period for each award, which was previously used for its pro forma information. Stock-based non-cash compensation expenses related to stock options, restricted stock grants and the employee stock purchase plan were recorded in the financial statements as follows (in thousands):

	Three Months Ended March 31, (unaudited)	
	2011	2010
Cost of revenues	$ 17	$ 28
Selling and marketing	584	632
Research and development	505	586
General and administrative	1,001	1,011
Total non-cash stock compensation expense	$ 2,107	$ 2,257

Total stock-based compensation for each quarter includes cash payment of income taxes related to grants of restricted stock in the amount of $0.9 million in the three months ended March 31, 2011 and $0.5 million in the three months ended March 31, 2010.

Stock Options

A summary of the Company s stock options outstanding under the 2005 Plan as of March 31, 2011, and the activity during the three months then ended, are as follows:

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	Shares		Weighted Ave. Exercise Price		Aggregate Intrinsic Value
	(in thousands except per share amounts)				
Outstanding as of December 31, 2010	2,706	$	11.69		
Granted (unaudited)		$			
Exercised (unaudited)	(6)	$	1.29		
Cancelled (unaudited)	(1)	$	12.72		
Outstanding as of March 31, 2011 (unaudited)	2,699	$	11.71	$	
Exercisable as of March 31, 2011 (unaudited)	2,653	$	11.68	$	

During the three months ended March 31, 2011, options to acquire 5,688 shares were exercised with an intrinsic value of $46,000, resulting in cash proceeds to the Company of $7,000. There were no stock options granted during the three months ended March 31, 2011. For the quarter ended March 31, 2011, there was $0.1 million of total unrecognized compensation costs related to non-vested stock options granted under the Plan, which will be recognized by December 31, 2011. At March 31, 2011, there were 1.4 million shares available for future grants under the 2005 Stock Issuance / Stock Option Plan.

Additional information regarding options outstanding as of March 31, 2011 is as follows:

	Options outstanding				Options exercisable		
Range of exercise prices	Number outstanding (in thousands)	Weighted average remaining contractual life (years)		Weighted average exercise price	Number exercisable (in thousands)		Weighted average exercise price
$0.24 - $4.00	157	3.0	$	1.62	157	$	1.62
$4.01 - $6.00	469	4.3	$	4.95	468	$	4.95
$6.01 - $12.00	180	6.5	$	8.81	165	$	8.90
$12.01 - $14.00	894	5.9	$	12.65	891	$	12.65
$14.01 - $16.00	630	6.0	$	15.18	626	$	15.18
$16.01 - $19.00	369	6.2	$	17.77	346	$	17.83
	2,699	5.5	$	11.71	2,653	$	11.68

Restricted Stock Awards

A summary of the Company s restricted stock awards outstanding under the 2005 Plan as of March 31, 2011, and the activity during the three months then ended, are as follows (in thousands):

	Shares
Unvested at December 31, 2010	1,604
Granted (unaudited)	910
Cancelled/forfeited (unaudited)	(41)
Vested (unaudited)	(261)

Unvested at March 31, 2011 (unaudited)	2,212

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5. 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 expenses 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.

6. 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 March 31, 2011 and December 31, 2010, bank balances totaling approximately $2.9 million and $17.6 million, respectively, were uninsured.

7. 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):

March 31, 2011			December 31, 2010		
Fair value	Amortized cost basis	Net unrealized gain (loss)	Fair value	Amortized cost basis	Net unrealized gain (loss)
$ 48,271	$ 48,279	$ (5)	$ 39,691	$ 39,704	$ (8)

Corporate notes, bonds and paper										
Government securities	8,412		8,414		(1)	15,003		15,007		(2)
Total	$ 56,683	$	56,693	$	(6)	$ 54,694	$	54,711	$	(10)

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8. Accounts Receivable

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

9. Inventories

Inventories consist principally of cables, 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 March 31, 2011, our net inventory balance consisted of approximately $0.2 million of assembled products and $0.2 million of components.

10. 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.

11. Goodwill

In accordance with FASB ASC Topic No. 350, Intangibles-Goodwill and Other, we review the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. The Company s annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the fair value of the Company s reporting units to the carrying value of the underlying net assets in the reporting units. If the fair value of a reporting unit is determined to be less than the carrying value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the fair value of the reporting unit and the fair value of its other assets and liabilities. We determined that we did not have any impairment of goodwill at December 31, 2010 and we have not noted any triggering events that would indicate impairment as of March 31, 2011.

The carrying amount of the Company s goodwill was $94.2 million as of March 31, 2011 and December 31, 2010.

12. Intangible Assets

The following table sets forth our acquired intangible assets by major asset class as of March 31, 2011 and December 31, 2010 (in thousands except useful life data):

	Useful life (years)	**March 31, 2011 Gross**	**March 31, 2011 Accumulated amortization**	**March 31, 2011 Net book value**	**December 31, 2010 Gross**	**December 31, 2010 Accumulated amortization**	**December 31, 2010 Net book value**
Amortizing:							
Purchased technology	1-3	$ 7,347	$ (5,824)	$ 1,523	$ 7,347	$ (5,344)	$ 2,003
In process R&D	2	990	(124)	866	990	(62)	928
Capitalized software	1-7	23,846	(16,117)	7,729	23,846	(15,336)	8,510
Customer lists	3-5	1,484	(1,372)	112	1,484	(1,328)	156
Database	10	182	(61)	121	182	(56)	126
Trademarks	5-10	926	(559)	367	926	(537)	389
Trade names	1-7	2,121	(1,307)	814	2,121	(1,208)	913
Non-compete	2	21	(15)	6	21	(13)	8
Customer relationships	4-7	11,130	(5,239)	5,891	11,130	(4,704)	6,426
Totals		$ 48,047	$ (30,618)	$ 17,429	$ 48,047	$ (28,588)	$ 19,459

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Aggregate amortization expense on intangible assets was $2.0 million for the three months ended March 31, 2011. Expected future amortization expense is as follows: $5.8 million for the remainder of 2011, $5.7 million for 2012, $4.8 million for 2013, $1.1 million thereafter.

We determined that we did not have any impairment of long-lived assets at December 31, 2010 and we have not noted any triggering events that would indicate impairment as of March 31, 2011.

13. Comprehensive Income

Comprehensive income includes unrealized gains and losses on short-term investments of U.S. government agency and government sponsored enterprise debt and equity securities. The following table sets forth the calculation of comprehensive income (loss) (in thousands):

	Three Months Ended March 31, (unaudited)	
	2011	2010
Net income (loss)	$ (7,753)	$ 1,592
Change in unrealized gain (loss) on investments, net	4	(19)
Total comprehensive income (loss)	$ (7,749)	$ 1,573

14. 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 connectivity and security management, mobile VPN, media and content management, device management, Push-To-Talk, Visual Voicemail, Visual Voicemail to Text, contact and calendar syncing and video content delivery and optimization solutions. Productivity & Graphics includes retail and direct sales of our compression and broad consumer-based software. Corporate/Other revenue includes the consulting portion of our services sector which has been de-emphasized and is no longer considered a strategic element of our future plans.

The Company does not separately allocate operating expenses to these business units, nor does it allocate specific assets. Therefore, business unit information reported includes only revenues.

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

	Three Months Ended March 31, (unaudited)	
	2011	**2010**
Wireless	$ 15,981	$ 26,962
Productivity & Graphics	1,742	2,774
Corporate/Other	68	126
Total revenues	17,791	29,862

Customer Concentration:

Sales to four customers and their respective affiliates in the Wireless business segment accounted for 21.4%, 20.0%, 13.3% and 12.7% of the Company s total revenues for the three months ended March 31, 2011. Sales to four customers and their respective affiliates in the Wireless business segment accounted for 28.3%, 22.2%, 12.7% and 10.0% of the Company s total revenues for the three months ended March 31, 2010.

Geographical Information:

During the three months ended March 31, 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):

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	Three Months Ended March 31, (unaudited)	
	2011	2010
Americas	$ 16,457	$ 28,015
EMEA	860	1,483
Asia Pacific	474	364
Total revenues	$ 17,791	$ 29,862

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

15. Recent Accounting Pronouncements

In December 2010, the FASB issued ASU No. 2010-28, *Intangibles-Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force).* The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For the Company, this guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The Company adopted ASU No. 2010-28 this period and its adoption did not have an impact on its consolidated results of operations and financial condition.

In October 2009, the FASB issued ASU No. 2009-14, *Software (Topic 985): Certain Revenue Arrangements That Include Software Elements (a consensus of the FASB Emerging Issues Task Force).* This new guidance amends the scope of existing software revenue recognition accounting. Tangible products containing software components and non-software components that function together to deliver the product s essential functionality would be scoped out of the accounting guidance on software and accounted for based on other appropriate revenue recognition guidance. For the Company, this guidance is effective for all new or materially modified arrangements entered into on or after January 1, 2011 with earlier application permitted as of the beginning of a fiscal year. Full retrospective application of the new guidance is optional. This guidance must be adopted in the same period that the company adopts the amended accounting for arrangements with multiple deliverables described in the next paragraph. The Company adopted ASU No. 2009-14 this period and its adoption did not have an impact on its consolidated results of operations and financial condition.

In October 2009, the FASB issued ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*. ASU No. 2009-13 amends revenue recognition guidance for arrangements with multiple deliverables. The new guidance eliminates the residual method of revenue recognition and allows the use of management s best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence (VSOE), vendor objective evidence (VOE) or third-party evidence (TPE) is unavailable. For the Company, this guidance is effective for all new or materially modified arrangements entered into on or after January 1, 2011 with earlier application permitted as of the beginning of a fiscal year. Full retrospective application of the new guidance is optional. The Company adopted ASU No. 2009-13 this period and its adoption did not have an impact on its consolidated results of operations and financial condition.

16. 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 March 31, 2011 are as follows (in thousands):

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Year Ending December 31,	Operating
2011-9 months	$ 2,119
2012	3,054
2013	2,770
2014	2,426
2015	2,383
2016	2,127
Beyond	7,239
Total	$ 22,118

Rent expense under operating leases for the three months ended March 31, 2011 and 2010 was $0.7 million and $0.6 million, respectively.

17. Income Taxes

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 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. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or the entire deferred tax asset will not be realized. Based on our evaluation, we believe all of the deferred tax assets as of March 31, 2011 are more likely than not to be realized and that no valuation allowance is required at this time.

We recorded an income tax benefit of $5.2 million for the three months ended March 31, 2011. We recorded income tax expenses of $1.4 million for the three months ended March 31, 2010. The effective tax rate for the three months ended March 31, 2011 was 40%, which was lower than the 46% for the three months ended March 31, 2010, primarily due to the ability to claim income tax benefits for state tax credits.

In July 2006, the FASB clarified the accounting for uncertainty in income taxes recognized in the financial statements. A tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation process, based on the technical merits. The Company adopted this FASB guidance effective January 1, 2007 and did not record any unrecognized tax benefits from uncertain tax positions at adoption. Based on our evaluation for the three months ended March 31, 2011, we have concluded that there are no significant uncertain tax positions requiring recognition on our financial statements. Our evaluation was performed for the tax years ended December 31, 2006, 2007, 2008, and 2009, the tax years which remain subject to examination by major tax jurisdictions as of March 31, 2011.

We may from time to time be assessed interest or penalties by major tax jurisdictions, although any such assessments historically have been minimal and immaterial to our financial results. It is the Company s policy to classify any interest and/or penalties in the financial statements as a component of general and administrative expense.

In March 2011, the Internal Revenue Service began its examination of the Company s U.S. federal tax return for the year ended December 31, 2008. The exam is expected to be completed by year-end 2011.

18. Subsequent Events

The Company evaluates and discloses subsequent events as required by ASC Topic No. 855, Subsequent Events. The Topic establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. Subsequent events have been evaluated as of the date of this filing and no further disclosures were required.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

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

This report contains forward-looking statements regarding Smith Micro which include, but are not limited to, statements concerning 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:

- *the continued economic slowdown and uncertainty and its effects on capital expenditures by 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;*
- *changes in demand for our products from our customers and their end-users;*
- *the intensity of the competition and our ability to successfully compete;*
- *the pace at which the market for new products develop;*
- *the response of competitors, many of whom are bigger and better financed than us;*
- *our ability to successfully execute our business plan and control costs and expenses;*
- *our ability to protect our intellectual property and our ability to not infringe on the rights of others; and*
- *those additional factors which are listed under the section Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010.*

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

Overview

Smith Micro Software, Inc. designs, develops and markets software products and services primarily for the mobile computing and communications industries. The Company is focused on developing connectivity, communications and content management solutions for a converging world of wireless and wired networks. The Company s portfolio of wireless software products and services includes a wide range of software solutions including our QuickLink® family of products. We provide mobile voice and data connectivity across 3G, 4G and Wi-Fi networks. Our mobile communications portfolio includes solutions for Push-To-Talk, Visual Voicemail, Visual Voicemail to Text, mobile device management and video. We also offer user-friendly solutions for the management of mobile content, contacts, and calendar data and managed file transfers.

We sell our 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 broadband mobile wireless technologies is providing new opportunities for our products and services on a global basis. When these broadband wireless technologies EVDO, UMTS/HSPA, Wi-Fi, LTE and WiMAX are combined with new devices such as mobile phones, Personal Computers, Smartphones, Netbooks, and tablets and emerging Machine-to-Machine (M2M) devices, opportunities emerge for new communications software products. Our core technologies are designed to address these emerging mobile connectivity and convergence opportunities.

Our innovative line of productivity and graphics products are distributed through a variety of consumer channels worldwide, our online stores, and third-party wholesalers, retailers and value-added resellers. We offer products that operate on Windows, Mac, UNIX, Linux, Apple iPhone/iPad, Android, Windows Mobile, Symbian and Java platforms.

Sales to four customers and their respective affiliates in the Wireless business segment accounted for 21.4%, 20.0%, 13.3% and 12.7% of the Company s total revenues for the three months ended March 31, 2011. Sales to four customers and their respective affiliates in the Wireless business segment accounted for 28.3%, 22.2%, 12.7% and 10.0% of the Company s total revenues for the three months ended March 31, 2010.

Results of Operations

The table below sets forth certain statements of operations data expressed as a percentage of revenues for the three months ended March 31, 2011 and 2010. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

	Three Months Ended March 31,	
	2011	2010
Revenues	100.0%	100.0%
Cost of revenues	21.2	12.5
Gross profit	78.8	87.5
Operating expenses:		
Selling and marketing	47.0	24.4
Research and development	65.6	33.9
General and administrative	39.3	19.5
Total operating expenses	151.9	77.8
Operating income (loss)	-73.1	9.7
Interest and other income	0.2	0.2
Income (loss) before taxes	-72.9	9.9
Income tax expense (benefit)	-29.3	4.6
Net income (loss)	-43.6%	5.3%

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 connectivity and security management, mobile VPN, media and content management, device management, Push-To-Talk, Visual Voicemail, Visual Voicemail to Text, contact and calendar syncing, video content delivery and optimization solutions and managed file transfers; and
- Productivity & Graphics, which includes retail and direct sales of our compression and broad consumer-based software.

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

	Three Months Ended March 31,	
	2011	2010
Wireless	$ 15,981	$ 26,962
Productivity & Graphics	1,742	2,774
Corporate/Other	68	126
Total revenues	17,791	29,862
Cost of revenues	3,776	3,732
Gross profit	$ 14,015	$ 26,130

Corporate/Other refers to the consulting portion of our services sector which has been de-emphasized and is no longer 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.

Interest and other income. Interest and other income are directly 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.

Income tax expense. The Company accounts for income taxes as required by FASB ASC Topic No. 740, Income Taxes. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in the Company s financial statements or tax returns. Measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and tax bases of the Company s assets and liabilities result in a deferred tax asset, we are required to evaluate the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or the entire deferred tax asset will not be realized. Based on our evaluation, we believe all of the deferred tax assets at March 31, 2011 are likely to be realized.

In July 2006, the FASB clarified the accounting for uncertainty in income taxes recognized in the financial statements. A tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation process, based on the technical merits.

Income tax positions must meet a more likely-than-not recognition threshold at the effective date to be recognized upon the adoption of new FASB guidance, and in subsequent periods. The interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We adopted this FASB guidance effective January 1, 2007.

Three Months Ended March 31, 2011 Compared to the Three Months Ended March 31, 2010

Revenues. Revenues were $17.8 million and $29.9 million for the three months ended March 31, 2011 and 2010, respectively, representing a decrease of $12.1 million, or 40.4%. Wireless revenues decreased $11.0 million, or 40.7%, primarily due to low current period orders as a result of high inventory levels of our connection manager product at a key customer. Productivity & Graphics revenues decreased $1.0 million, or 37.2% due to continued low consumer spending. Corporate/Other sales decreased $0.1 million as we have de-emphasized this business.

Cost of revenues. Cost of revenues was $3.8 million and $3.7 million for the three months ended March 31, 2011 and 2010, representing an increase of $0.1 million, or 1.2%. Direct product costs increased $0.3 million primarily due to a shift in product mix and increased costs related to our backup and messaging products. Amortization of intangibles decreased from $1.5 million to $1.3 million, or $0.2 million.

Gross profit. Gross profit was $14.0 million, or 78.8% of revenues for the three months ended March 31, 2011, a decrease of $12.1 million, or 46.4%, from $26.1 million, or 87.5% of revenues for the three months ended March 31, 2010. The 8.7 percentage point decrease was primarily due to lower product margins of 6.6 points as a result of the change in product mix and the lower revenues not absorbing our datacenter-related fixed costs associated with our backup and messaging products. Amortization of intangibles as a percentage of revenues increased 2.1 points due to the lower revenues.

Selling and marketing. Selling and marketing expenses were $8.4 million and $7.3 million for the three months ended March 31, 2011 and 2010, respectively, representing an increase of $1.1 million, or 14.7%. This increase was primarily due to higher personnel costs of $0.5 million, higher travel of $0.4 million and higher promotion expense for our new products of $0.3 million. Amortization of intangibles decreased from $0.8 million to $0.7 million, or $0.1 million. Stock-based compensation expense was $0.8 million for both of the three months ended March 31, 2011 and 2010.

Research and development. Research and development expenses were $11.7 million and $10.1 million for the three months ended March 31, 2011 and 2010, respectively, representing an increase of $1.6 million, or 15.3%. This increase was primarily due to additional headcount of $1.2 million to support our new product initiatives and higher travel and supplies related to these new projects of $0.3 million. Amortization of intangibles increased from zero to $0.1 million. Stock-based compensation was $0.6 million for both of the three months ended March 31, 2011 and 2010.

General and administrative. General and administrative expenses were $7.0 million and $5.8 million for the three months ended March 31, 2011 and 2010, respectively, representing an increase of $1.2 million, or 20.3%. This increase was primarily due to increased space and occupancy costs associated with facility expansions of $0.5 million, personnel costs of $0.3 million, other cost increases of $0.2 million and higher stock-based compensation expense which increased from $1.3 million to $1.5 million, or $0.2 million.

Interest and other income. Interest and other income was $0.1 million for both of the three months ended March 31, 2011, and 2010.

Income tax provision. We recorded an income tax benefit of $5.2 million for the three months ended March 31, 2011. We recorded income tax expense of $1.4 million for the three months ended March 31, 2010. The effective tax rate for the three months ended March 31, 2011 was 40%, which was lower than the 46% for the three months ended March 31, 2010, primarily due to the ability to claim income tax benefits for state tax credits.

Liquidity and Capital Resources

At March 31, 2011, we had $64.4 million in cash and cash equivalents and short-term investments and $79.8 million of working capital. Capital expenditures increased $5.3 million for the three months ended March 31, 2011 versus the three months ended March 31, 2010 as we expanded our Aliso Viejo datacenter and built out our new Pittsburgh facility. We anticipate additional datacenter capital expenditures throughout the year to increase the capacity for our product offerings. We believe that our existing cash, cash equivalents, and short-term investment balances and cash flow from operations will be sufficient to finance our working capital and capital expenditure requirements through at least the next twelve months. We may require additional funds to support our working capital requirements or for other purposes and may seek to raise additional funds through public or private equity or debt financing or from other sources. If additional financing is needed, we cannot assure that such financing will be available to us at commercially reasonable terms or at all.

Operating activities

Net cash used by operating activities was $2.3 million for the three months ended March 31, 2011. The primary uses of operating cash were our net loss of $7.8 million, the increase of deferred tax assets of $5.5 million and other assets increasing by $0.3 million. These were partially offset by a decrease in accounts receivable of $4.8 million, non-cash expenses including depreciation and amortization of $2.7 million, stock-based compensation of $2.1 million and increases of current liabilities of $1.7 million. Net cash provided by operating activities was $4.9 million for the three months ended March 31, 2010. The primary sources of operating cash were adjustments for non-cash expenses including depreciation and amortization of $2.9 million, stock-based compensation of $2.3 million, net income and other non-cash expenses of $1.6 million, increases of current liabilities of $0.6 million, and decreases of other assets of $0.2 million. The primary use of cash affecting operating cash flow was an increase in accounts receivable of $2.7 million.

Investing activities

During the three months ended March 31, 2011, we used $8.5 million in investing activities due to investing in capital expenditures of $6.5 million as we expanded our Aliso Viejo datacenter and built out our new Pittsburgh facility and short-term investments of $2.0 million. During the three months ended March 31, 2010, we used $8.5 million in investing activities due to investing in short-term investments of $6.5 million, capital expenditures of $1.3 million, and for a small acquisition of $0.7 million.

Financing activities

During the three months ended March 31, 2011, we received $0.3 million from the stock sale for the employee stock purchase plan and $0.3 million from tax benefits related to stock-based compensation. During the three months ended March 31, 2010, we received $0.2 million in cash from the exercise of stock options and $0.4 million from tax benefits related to stock-based compensation.

Contractual obligations and commercial commitments

As of March 31, 2011 we had no debt. The following table summarizes our contractual obligations as of March 31, 2011 (in thousands):

		Payments due by period			
Contractual obligations:	**Total**	**1 year or less**	**1-3 years**	**3-5 years**	**More than 5 years**
Operating Lease Obligations	$ 22,118	$ 2,914	$ 5,688	$ 4,750	$ 8,766
Purchase Obligations	1,738	1,738			
Total	$ 23,856	$ 4,652	$ 5,688	$ 4,750	$ 8,766

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 21,000 square feet in Mountain View, California under a lease that expires February 28, 2014. We lease approximately 14,400 square feet in Chicago, Illinois under a lease that expires August 31, 2012. We lease approximately 15,300 square feet in Watsonville, California under a lease that expires September 30, 2018. We lease approximately 7,700 square feet in Herndon, Virginia under a lease that expires May 31, 2011. We lease approximately 4,200 square feet in Austin, Texas under a lease that expires June 30, 2011. Internationally, we lease space in Stockholm, Sweden; Belgrade, Serbia; Oslo, Norway; and Vancouver, Canada. These leases are for one to six-year terms.

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 the estimates appropriately reflect changes in our business or new information as it becomes available.

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

Revenue Recognition

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 collectibility 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 titles 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. 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). As of January 1, 2011, we adopted ASU No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* which amends revenue recognition guidance for arrangements with multiple deliverables. The new guidance eliminated the residual method of revenue recognition and allows the use of management s best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence (VSOE), vendor objective evidence (VOE) or third-party evidence (TPE) is unavailable. For most of our multiple element agreements, VSOE for all contract elements is used and the timing of the individual element revenue streams is determined and recognized as delivered.

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 $0.1 million for the both of the three months ended March 31, 2011 and 2010.

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.

In-Process Research and Development

In 2009, we capitalized $1.0 million of IPR&D costs related to our acquisition of Core Mobility in accordance with accounting standards that became effective in 2009. This IPR&D project was completed during the fourth quarter of 2010. As such, amortization has commenced and will continue over its estimated useful life.

The fair value of the IPR&D was determined using the discounted cash flow approach. The expected future cash flows were estimated and discounted to their net present values at an appropriate risk-adjusted rate of return. Significant factors considered in the calculation of the rate of return were the weighted average cost of capital and return on assets, as well as the risks inherent in the development process, including the likelihood of achieving technological success and market acceptance. Future cash flows were estimated based on forecasted revenue and costs, taking into account the expected product life cycle, market penetration and growth rates.

Capitalized Software and Amortization

We capitalize internally developed software and software purchased from third parties if the related software product under development has reached technological feasibility or if there are alternative future uses for the purchased software as required by FASB ASC Topic No. 985-20, Software-Costs of Software to be Sold, Leased, or Marketed. These costs are amortized on a product-by-product basis, typically over an estimated life of five to seven years, using the larger of the amount calculated using the straight-line method or the amount calculated using the ratio between current period gross revenues and the total of current period gross revenues and estimated future gross revenues. At each balance sheet date, we evaluate on a product-by-product basis the unamortized capitalized cost of computer software compared to the net realizable value of that product. The amount by which the unamortized capitalized costs of a computer software product exceed its net realizable value is written off.

Intangible Assets and Amortization

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

Impairment or Disposal of Long Lived Assets

Long-lived assets to be held are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. They are tested for recoverability using undiscounted cash flows to determine whether or not impairment to such value has occurred as required by FASB ASC Topic No. 360, Property, Plant, and Equipment. The Company has determined that there was no impairment at March 31, 2011.

Valuation of Goodwill and Intangible Assets

The Company accounts for goodwill and intangible assets as required by FASB ASC Topic No. 350, Intangibles-Goodwill and Other. This statement requires us to periodically assess the impairment of our goodwill and intangible assets, which requires us to make assumptions and judgments regarding the carrying value of these assets. These assets are considered to be impaired if we determine that their carrying value may not be recoverable based upon our assessment of the following events or changes in circumstances:

- a determination that the carrying value of such assets cannot be recovered through undiscounted cash flows;
- loss of legal ownership or title to the assets;
- significant changes in our strategic business objectives and utilization of the assets; or
- the impact of significant negative industry or economic trends.

If the intangible assets are considered to be impaired, the impairment we recognize is the amount by which the carrying value of the intangible assets exceeds the fair value of the intangible assets. In addition, we base the useful lives and the related amortization expense on our estimate of the useful life of the intangible assets. Due to the numerous variables associated with our judgments and assumptions relating to the carrying value of our intangible assets and the effects of changes in circumstances affecting these valuations, both the precision and reliability of the resulting estimates are subject to uncertainty, and as additional information becomes known, we may change our estimate, in which case, the likelihood of a material change in our reported results would increase.

In accordance with FASB ASC Topic No. 350, Intangibles-Goodwill and Other, we review the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. Our annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the estimated fair value of our reporting units to the carrying value of the underlying net assets in the reporting units. If the estimated fair value of a reporting unit is determined to be less than the fair value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the estimated fair value of the reporting unit and the fair value of its other assets and liabilities. In accordance with FASB issued ASU No. 2010-28, *Intangibles-Goodwill and Other (Topic 350): When to Perform Step*

2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force, reporting units with zero or negative carrying amounts are required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that impairment may exist. The qualitative factors are consistent with the existing guidance which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. We determined that we did not have any impairment of goodwill at March 31, 2011 or December 31, 2010. Estimates of reporting unit fair value are based upon market capitalization and therefore are volatile being sensitive to market fluctuations. To the extent that our market capitalization decreases significantly or the carrying value changes, we could be required to write off some or all of our goodwill.

Income Taxes

We account for income taxes as required by FASB ASC Topic No. 740, Income Taxes. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in our financial statements or tax returns. The measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and the tax bases of our assets and liabilities result in a deferred tax asset, we are required to evaluate the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or the entire deferred tax asset will not be realized. The Company s net deferred tax assets were not reduced by a tax valuation allowance at March 31, 2011. Management evaluated the positive and negative evidence in determining the realizability of the net deferred tax assets at March 31, 2011 and concluded it is more likely than not that the Company should realize its net deferred tax assets through future operating results and the reversal of taxable temporary differences.

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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

Our financial instruments include cash and cash equivalents and short-term investments. At March 31, 2011, the carrying values of our financial instruments approximated fair values based on current market prices and rates.

Foreign Currency Risk

While a majority of our business is denominated in U.S. dollars, we do invoice in foreign currencies. For the three months ended March 31, 2011 and 2010, our revenues denominated in foreign currencies were $0.2 million and $0.4 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 4. Controls and Procedures.

Evaluation of disclosure controls and procedures

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 (Exchange Act)) as of March 31, 2011. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have determined that as of March 31, 2011, 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

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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 March 31, 2011 that have materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time we may be party to litigation incidental to our business, none of which is expected to have a material adverse effect on us.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for our fiscal year ended December 31, 2010. The risks discussed in our Annual Report on Form 10-K could materially affect our business, financial condition and future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or operating results.

Item 6. Exhibits.

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SMITH MICRO SOFTWARE, INC.

May 5, 2011	By /s/ William W. Smith, Jr. William W. Smith, Jr. President and Chief Executive Officer *(Principal Executive Officer)*
May 5, 2011	By /s/ Andrew C. Schmidt Andrew C. Schmidt Vice President and Chief Financial Officer *(Principal Financial Officer)*

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