SMITH MICRO SOFTWARE INC
Form 10-Q
August 04, 2009

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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 June 30, 2009

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)	Small reporting company o

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

As of July 31, 2009 there were 32,399,000 shares of common stock outstanding.

SMITH MICRO SOFTWARE, INC.
QUARTERLY REPORT ON FORM 10-Q
June 30, 2009
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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, 2009 (unaudited)	December 31, 2008 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 14,048	$ 13,966
Short-term investments	29,784	22,649
Accounts receivable, net of allowances for doubtful accounts and other adjustments of $1,222 (2009) and $1,204 (2008)	22,126	18,424
Inventories, net of reserves for obsolete inventory of $749 (2009) and $404 (2008)	609	1,097
Prepaid expenses and other current assets	1,127	1,026
Deferred tax asset	1,412	1,698
Total current assets	69,106	58,860
Equipment and improvements, net	6,815	4,289
Goodwill	83,483	83,483
Intangible assets, net	23,316	27,603
Deferred tax asset	2,760	2,760
Total assets	$ 185,480	$ 176,995
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 3,742	$ 3,492
Accrued liabilities	6,194	6,710
Deferred revenue	3,299	923
Total current liabilities	13,235	11,125
Long-term liabilities	343	466
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value $0.001 per share; 5,000,000 shares authorized; none issued or outstanding		
Common stock, par value $0.001 per share; 50,000,000 shares authorized; 32,399,000 and 31,400,000 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	32	31
Additional paid-in capital	170,843	165,864
Accumulated other comprehensive income	32	69
Accumulated earnings (deficit)	995	(560)

Total stockholders equity		171,902		165,404
Total liabilities and stockholders equity	$	185,480	$	176,995

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 June 30,		Six Months Ended June 30,	
	2009 (unaudited)	2008 (unaudited)	2009 (unaudited)	2008 (unaudited)
Revenues	$ 25,986	$ 23,452	$ 49,774	$ 45,332
Cost of revenues	3,922	5,463	8,445	10,579
Gross profit	22,064	17,989	41,329	34,753
Operating expenses:				
Selling and marketing	6,148	5,839	12,425	12,574
Research and development	8,725	7,853	16,837	14,922
General and administrative	4,508	4,766	8,995	9,614
Total operating expenses	19,381	18,458	38,257	37,110
Operating income (loss)	2,683	(469)	3,072	(2,357)
Interest and other income	119	141	374	416
Profit (loss) before taxes	2,802	(328)	3,446	(1,941)
Income tax expense (benefit)	1,525	(170)	1,891	(1,466)
Net income (loss)	$ 1,277	$ (158)	$ 1,555	$ (475)
Net income (loss) per share:				
Basic	$ 0.04	$ (0.01)	$ 0.05	$ (0.02)
Diluted	$ 0.04	$ (0.01)	$ 0.05	$ (0.02)
Weighted average shares outstanding:				
Basic	32,338	30,855	32,008	30,637
Diluted	32,955	30,855	32,464	30,637

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		Additional paid-in	Accumulated other comprehensive income (loss)	Accumulated income (deficit)	
	Shares	Amount	capital			Total
BALANCE, December 31, 2008	**31,400**	**$ 31**	**$ 165,864**	**$ 69**	**$ (560)**	**$ 165,404**
Exercise of common stock options	141		593			593
Non cash compensation recognized on stock options			2,853			2,853
Restricted stock grants	869	1	1,761			1,762
Cancellation of shares for payment of withholding tax	(11)		(63)			(63)
Excess tax benefit related to stock compensation			121			121
Tax deficiencies related to stock compensation			(286)			(286)
Other comprehensive income:						
Change in unrealized loss on short-term investments				(37)		(37)
Net income					1,555	1,555
Total comprehensive income						1,518
BALANCE, June 30, 2009	**32,399**	**$ 32**	**$ 170,843**	**$ 32**	**$ 995**	**$ 171,902**

See accompanying notes to the unaudited consolidated financial statements.

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

	Six Months Ended June 30,	
	2009	2008
	(unaudited)	(unaudited)
Operating activities:		
Net income (loss)	$ 1,555	$ (475)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities, net of the effect of acquisitions:		
Depreciation and amortization	5,030	3,039
Loss on disposal of assets	20	
Provision for doubtful accounts and other adjustments to accounts receivable	623	436
Provision for excess and obsolete inventory	511	120
Tax benefits from stock-based compensation	(121)	(53)
Non cash compensation related to stock options & restricted stock	4,615	6,176
Change in operating accounts, net of effect from acquisitions:		
Accounts receivable	(4,325)	(7,141)
Deferred income taxes		(1,492)
Income tax receivable		(54)
Inventories	(23)	342
Prepaid expenses and other assets	(101)	139
Accounts payable and accrued liabilities	2,045	(442)
Net cash provided by operating activities	9,829	595
Investing activities:		
Adjustments made to the acquisition of eFrontier America		(218)
Adjustments made to the acquisition of Insignia Solutions		245
Acquisition of PCTel s Mobile Solutions Group, net of cash received		(60,911)
Capital expenditures	(3,289)	(1,218)
Purchase of short-term investments	(7,172)	(1,748)
Net cash used in investing activities	(10,461)	(63,850)
Financing activities:		
Tax benefits from stock-based compensation	121	53
Cash received from exercise of stock options	593	64
Net cash provided by financing activities	714	117
Net increase (decrease) in cash and cash equivalents	82	(63,138)
Cash and cash equivalents, beginning of period	13,966	87,549
Cash and cash equivalents, end of period	$ 14,048	$ 24,411

Supplemental disclosures of cash flow information:		
Cash paid for income taxes	$ 2,177	$ 311

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 mobi software products and services and an extensive line of personal computing graphic and utility software products. We sell our products and services to many of the world s leading wireless mobile operators (carriers & cable), original equipment manufacturers (OEM) Personal Computer (PC) and device manufacturers, enterprise businesses, as well as direct to consumers.

On December 10, 2007, Smith Micro entered into an Asset Purchase Agreement with PCTEL, Inc. pursuant to which Smith Micro agreed to acquire substantially all of the assets of PCTEL s Mobility Solutions Group (MSG). Pursuant to the terms of the Asset Purchase Agreement, Smith Micro paid $59.7 million in cash to PCTEL at the closing on January 4, 2008.

2. Basis of Presentation

The accompanying interim consolidated balance sheet and statement of equity as of June 30, 2009, and the related statements of operations and cash flows for the six months ended June 30, 2009 and 2008 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 and 10-K/A for the fiscal year ended December 31, 2008 filed with the SEC on March 10, 2009 and April 29, 2009, respectively.

Intercompany balances and transactions have been eliminated in consolidation.

Operating results for the three and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for any other interim period or for the fiscal year ending December 31, 2009.

3. Net Income (Loss) Per Share

The Company calculates earnings per share in accordance with the Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings per Share*. Basic earnings per share (EPS) is calculated by dividing the net income/loss 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/loss available to common stockholders by the weighted average number of common shares outstanding for the period plus the weighted average number of dilutive common stock equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, common stock subject to repurchase by the Company and options are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(unaudited, in thousands, except per share amounts)			
Numerator:				
Net income (loss) available to common stockholders	$ 1,277	$ (158)	$ 1,555	$ (475)
Denominator:				
Weighted average shares outstanding - basic	32,338	30,855	32,008	30,637
Potential common shares - options (treasury stock method)	617		456	
Weighted average shares outstanding - diluted	32,955	30,855	32,464	30,637
Shares excluded (anti-dilutive)		3,706		3,719
Shares excluded due to an exercise price greater than weighted average stock price for the period	2,475		2,624	
Net income (loss) per common share:				
Basic	$ 0.04	($0.01)	$ 0.05	($0.02)
Diluted	$ 0.04	($0.01)	$ 0.05	($0.02)

4. Acquisitions

PCTEL S Mobility Solutions Group

On January 4, 2008, the Company acquired substantially all of the assets of PCTEL S Mobility Solutions Group in exchange for $59.7 million in cash. The direct acquisition costs incurred to date include $1.2 million of legal and professional services.

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

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

Cash consideration	$ 59,700
Acquisition related costs	1,231
Total purchase price	$ 60,931

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

Assets:	
Property & Equipment	$ 718

Intangible Assets	13,050
Goodwill	50,319
Total Assets	64,087
Liabilities:	
Deferred Revenue	3,156
Total Liabilities	3,156
Total purchase price	$ 60,931

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5. Stock-Based Compensation

Stock Plans

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

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

SFAS 123(R)

Effective January 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment,* which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including stock options based on their fair values. SFAS No. 123(R) supersedes Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, which the Company previously followed in accounting for stock-based awards. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107 to provide guidance on SFAS No. 123(R). The Company has applied SAB No. 107 in its adoption of SFAS No. 123(R).

The Company adopted SFAS No. 123(R) using the modified prospective transition method as of January 1, 2006. In accordance with the modified prospective transition method, the Company s financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Share-based compensation expense recognized is based on the value of the portion of share-based payment awards that is ultimately expected to vest. Share-based compensation expense recognized in the Company s consolidated statement of operations during the three and six months ended June 30, 2009 and 2008 includes compensation expense for share-based payment awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 123.

Valuation of Stock Option and Restricted Stock Awards

There were no stock options granted during the six months ended June 30, 2009. There were no stock options granted during the three months ended June 30, 2008. The weighted average grant-date fair value of stock options granted during the six months ended June 30, 2008 was $4.07. The assumptions used to compute the share-based compensation costs for the stock options granted during the six months ended June 30, 2008, using the Black-Scholes option pricing model, were as follows:

	Six Months Ended June 30, 2008 (unaudited)
Employee Stock Options	
Risk-free interest rate	2.9%
Expected dividend yield	

Weighted average expected life (years)	4
Volatility	71.0%
Forfeiture rate	3.5%

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The risk-free interest rate assumption was based on the United States Treasury s rates for U.S. Treasury zero-coupon bonds with maturities similar to those of the expected term of the award being valued. The Company assumed no dividend yield because it does not expect to pay dividends for the foreseeable future.

Grants of restricted stock are valued using the closing stock price on the date of grant. In the six months ended June 30, 2009, a total of 50,000 shares of restricted stock, with a total value of $0.2 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 $3.5 million, were granted to key officers and employees of the Company. This cost will be amortized over a period of 48 months.

Compensation Costs

In conjunction with the adoption of SFAS No. 123(R), the Company elected to attribute the value of share-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 required under SFAS No. 123. Share-based non-cash compensation expenses related to stock options and restricted stock grants were recorded in the financial statements as follows (in thousands):

	Three Months Ended June 30, (unaudited)		Six Months Ended June 30, (unaudited)	
	2009	2008	2009	2008
Cost of revenues	$ 56	$ 132	$ 129	$ 232
Selling and marketing	627	679	1,306	1,966
Research and development	649	881	1,256	1,648
General and administrative	909	1,145	1,924	2,330
Total non-cash stock compensation expense	$ 2,241	$ 2,837	$ 4,615	$ 6,176

Total share-based compensation for each quarter includes cash payment of income taxes related to grants of restricted stock in the amount of $0.2 million in the three months ended June 30, 2009 and $0.3 million in the three months ended June 30, 2008. The cash payment of income taxes related to grants of restricted stock totaled $0.5 million for the six months ended June 30, 2009 and $0.5 million for the six months ended June 30, 2008.

Stock Options

A summary of the Company s stock options outstanding under the 2005 Plan as of June 30, 2009, and the activity during the six months then ended, are as follows:

	Shares	**Weighted Ave. Exercise Price**	**Aggregate Intrinsic Value**
	(in thousands except per share amounts)		
Outstanding as of December 31, 2008	4,289	$ 10.94	
Granted (unaudited)		$	
Exercised (unaudited)	(141)	$ 4.21	
Cancelled (unaudited)	(334)	$ 14.28	
Outstanding as of June 30, 2009 (unaudited)	3,814	$ 10.81	$
Exercisable as of June 30, 2009 (unaudited)	2,672	$ 9.57	$ 617

During the six months ended June 30, 2009, options to acquire 141,000 shares were exercised with an intrinsic value of $0.8 million, resulting in cash proceeds to the Company of $0.6 million. There were no stock options granted during the six months ended June 30, 2009. For the three months ended June 30, 2009, there were $7.7 million of total unrecognized compensation costs related to non-vested stock options granted under the Plan, which will be recognized over a period not to exceed four years. At June 30, 2009, there were 1.5 million shares available for future grants under the 2005 Plan.

Additional information regarding options outstanding as of June 30, 2009 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	285	4.7	\$ 1.67	285	\$ 1.67
\$4.01 - \$6.00	856	6.1	\$ 4.95	832	\$ 4.95
\$6.01 - \$12.00	287	7.4	\$ 8.74	196	\$ 8.68
\$12.01 - \$14.00	1,310	7.6	\$12.68	770	\$12.69
\$14.01 - \$16.00	673	7.7	\$15.18	384	\$15.18
\$16.01 - \$19.00	403	7.9	\$17.80	205	\$17.88
	3,814	7.1	\$10.81	2,672	\$ 9.57

Restricted Stock Awards

A summary of the Company s restricted stock awards outstanding under the 2005 Plan as of June 30, 2009, and the activity during the six months then ended, are as follows (in thousands):

	Shares
Unvested at December 31, 2008	998
Granted (unaudited)	891
Cancelled (unaudited)	(21)
Vested (unaudited)	(240)
Unvested at June 30, 2009 (unaudited)	1,628

6. Fair Value of Financial Instruments

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*, which defines the fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. On February 12, 2008, the FASB issued FASB Staff Position (FSP) No. 157-2 which defers the effective date of SFAS No. 157 for one year for non-financial assets and non-financial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. Our adoption of SFAS No. 157 on January 1, 2008 did not have a material impact on the Company s financial position, results of operations or cash flows.

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.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to 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 will be required to be reported in earnings in the current period. SFAS No. 159 also establishes presentation and disclosure requirements for similar types of assets and liabilities measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. As permitted by SFAS No. 159, we have elected not to use the fair value option to measure our available-for-sale securities under SFAS No. 159 and will

continue to report under SFAS No. 115, *Accounting for Certain Investments in 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.

7. 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

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Corporation (FDIC) coverage, and have original maturity dates of three months or less. As of June 30, 2009 and December 31, 2008, bank balances totaling approximately $6.9 million and $14.0 million, respectively, were uninsured.

8. 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 in accordance with SFAS No. 115, *Accounting for Certain Investments in 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 shareholders equity until realized. All securities are accounted for on a specific identification basis. As of June 30, 2009, the following available-for-sale securities were in a gain position (in thousands):

	(unaudited)	
	Fair value	**Unrealized gain**
Holding period of less than 12 months:		
Corporate bonds and notes	$ 10,950	$ 9
Government securities	18,834	23
Total	$ 29,784	$ 32

SFAS No. 157 clarifies that 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, SFAS No. 157 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.

In accordance with SFAS No. 157, 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.

For the six months ended June 30, 2009, realized gains or losses on our short-term investments were essentially breakeven; reported in the interest and other income line on the consolidated statements of operations.

9. 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.

10. 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 June 30, 2009, our net inventory balance of $0.6 million consisted of approximately $0.2 million of assembled products and $0.4 million of components.

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11. 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.

12. Goodwill

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company reviews the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. The Company s annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the fair value of the Company s reporting units to the carrying value of the underlying net assets in the reporting units. If the fair value of a reporting unit is determined to be less than the carrying value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the fair value of the reporting unit and the fair value of its other assets and liabilities. We determined that we did not have any impairment of goodwill at December 31, 2008.

The carrying amount of the Company s goodwill was $83.5 million as of June 30, 2009 and December 31, 2008.

13. Intangible Assets

The following table sets forth our acquired intangible assets by major asset class as of June 30, 2009 and December 31, 2008 (dollars in thousands):

	Useful Life (Years)	June 30, 2009 (unaudited) Gross	Accumulated Amortization	Net Book Value	December 31, 2008 Gross	Accumulated Amortization	Net Book Value
Amortizing:							
Purchased Technology	1	$ 3,047	$ (2,496)	$ 551	$ 3,047	$ (1,836)	$ 1,211
Capitalized Software	5-7	23,846	(9,265)	14,581	23,846	(6,899)	16,947
Distribution Rights	5	482	(412)	70	482	(377)	105
Customer Lists	5	1,484	(862)	622	1,484	(676)	808
Database	10	182	(29)	153	182	(20)	162
Trademarks	10	809	(408)	401	809	(375)	434
Trade Names	1-2	2,121	(606)	1,515	2,121	(406)	1,715
Customer Agreements	4-7	1,135	(892)	243	1,135	(650)	485
Customer Relationships	1-9	7,020	(1,840)	5,180	7,020	(1,284)	5,736
Totals		$ 40,126	$ (16,810)	$ 23,316	$ 40,126	$ (12,523)	$ 27,603

Aggregate amortization expense on intangible assets was $2.1 million and $4.3 million for the three and six months ended June 30, 2009, respectively. Expected future amortization expense is as follows: $4.1 million for the remainder of 2009, $5.9 million for 2010, $5.5 million for 2011, $4.8 million for 2012, $2.2 million for 2013, and $0.8 million thereafter.

14. 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 (in thousands):

	Three Months Ended June 30, (unaudited)		Six Months Ended June 30, (unaudited)	
	2009	2008	2009	2008
Net income (loss)	$ 1,277	$ (158)	$ 1,555	$ (475)
Change in unrealized gain on investments, net	8		(37)	
Total comprehensive income (loss)	$ 1,285	$ (158)	$ 1,518	$ (475)

15. Segment and Geographical Information

Segment Information

The Company applies the provisions of SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. SFAS No. 131 requires public companies to report financial and descriptive information about their reportable operating segments. The Company identifies its operating segments based on how management internally evaluates separate financial information, business activities and management responsibility. The Company has two primary business units. Wireless includes our connection manager solutions for the OEM and Enterprise channels, music, photo and video content management, firmware over the air and products for the IMS application layer. Productivity & Graphics includes retail 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 June 30, (unaudited)		Six Months Ended June 30, (unaudited)	
	2009	2008	2009	2008
Wireless	$ 21,373	$ 16,836	$ 40,630	$ 32,992
Productivity & Graphics	4,332	6,220	8,583	11,705
Corporate/Other	281	396	561	635
Total Revenues	$ 25,986	$ 23,452	$ 49,774	$ 45,332

Sales to two customers and their respective affiliates in the Wireless business segment accounted for 35.6% and 13.0% of the Company s total revenues for the three months ended June 30, 2009. Sales to one customer in the Wireless business segment accounted for 40.9% of the Company s total revenues for the three months ended June 30, 2008. Sales to two customers and their respective affiliates in the Wireless business segment accounted for 32.1% and 13.6% of the Company s total revenues for the six months ended June 30, 2009. Sales to one customer in the Wireless business segment accounted for 42.4% of the Company s total revenues for the six months ended June 30, 2008.

Geographical Information

During the three and six months ended June 30, 2009 and 2008, the Company operated in three geographic locations: the Americas, Asia Pacific, and Europe, the Middle East, and Africa (EMEA). Revenues, attributed to the geographic location of the customer s bill-to address, were as follows (in thousands):

	Three Months Ended June 30, (unaudited)		Six Months Ended June 30, (unaudited)	
	2009	2008	2009	2008
Americas	$ 24,434	$ 20,732	$ 45,385	$ 40,513
Asia Pacific	666	1,546	1,985	2,607
EMEA	886	1,174	2,404	2,212
Total Revenues	$ 25,986	$ 23,452	$ 49,774	$ 45,332

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

16. Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, *The* FASB Accounting Standards Codification^{TM} *and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162.* SFAS No. 168 will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company will adopt SFAS No. 168 on its effective date and does not expect its adoption to have an impact on its consolidated results of operations and financial condition.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R).* SFAS No. 167 addresses (1) the effects on certain provisions of Financial Accounting Standards Board Interpretation (FIN) No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* as a result of the elimination of the qualifying special-purpose entity concept in SFAS No. 166, *Accounting for Transfers of Financial Assets,* and (2) constituent concerns about the application of certain key provisions of FIN No. 46(R), including those in which the accounting and disclosures under the Interpretation do not always provide timely and useful information about an enterprise s involvement in a variable interest entity. This Statement shall be effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company will adopt SFAS No. 167 on its effective date and does not expect its adoption to have an impact on its consolidated results of operations and financial condition.

In June 2009, the FASB issued SFAS No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140.* SFAS No. 166 was issued to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. This Statement must be applied as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Earlier application is prohibited. This Statement must be applied to transfers occurring on or after the effective date. The Company will adopt SFAS No. 166 on its effective date and does not expect its adoption to have an impact on its consolidated results of operations and financial condition.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*. SFAS No. 165 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. The Company has adopted SFAS No. 165. Subsequent events have been evaluated as of the date of this filing and no further disclosures were required and its adoption did not impact its consolidated results of operations and financial condition.

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 identifies the sources of accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP in the United States. This Statement is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Company currently adheres to the hierarchy of GAAP as presented in SFAS No. 162, and does not expect its adoption will have a material impact on its consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141(R) (Revised 2007), *Business Combinations.* The objective of SFAS No. 141(R) is to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations,

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resulting in more complete, comparable and relevant information for investors and other users of financial statements. SFAS No. 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS No. 141(R) includes both core principles and pertinent application guidance, eliminating the need for numerous Emerging Issues Task Force (EITF) issues and other interpretative guidance, thereby reducing the complexity of existing United States GAAP. SFAS No. 141(R) is effective as of the start of fiscal years beginning after December 15, 2008. Early adoption is not allowed. The Company has adopted SFAS no. 141(R) but the impact will not be known until there is another business acquisition.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements*. SFAS No. 160 improves the relevance, comparability, and transparency of financial information provided to investors by requiring all entities to report non-controlling (minority) interests in subsidiaries in the same way as equity in the consolidated financial statements. Moreover, SFAS No. 160 eliminates the diversity that currently exists in accounting for transactions between an entity and non-controlling interests by requiring they be treated as equity transactions. SFAS No. 160 is effective as of the start of fiscal years beginning after December 15, 2008. Early adoption is not allowed. The Company has adopted SFAS No. 160 and its adoption did not impact its consolidated results of operations and financial condition.

17. Commitments and Contingencies

Leases

The Company leases its buildings under operating leases that expire on various dates through 2016. Future minimum annual lease payments under such leases as of June 30, 2009 are as follows (in thousands):

Year Ending December 31,	**Operating**
2009-6 months	$ 794
2010	1,538
2011	1,546
2012	1,389
2013	920
2014	737
Beyond	1,080
Total	$ 8,004

Rent expense under operating leases for the three months ended June 30, 2009 and 2008 was $0.4 million and $0.5 million, respectively. Rent expense under operating leases for both the six months ended June 30, 2009 and 2008 was $0.9 million and $0.8 million, respectively.

18. Income Taxes

We adopted the provisions of FIN No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109,* on January 1, 2007. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*, 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. FIN No. 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements. Our evaluation was performed for the tax years ended December 31, 2005, 2006, 2007, and 2008, the tax years which remain subject to examination by major tax jurisdictions as of June 30, 2009.

In the three and six months ended June 30, 2009, we recorded income tax expense in the amount of $1.5 million and $1.9 million, respectively.

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. In the event we have received an assessment for interest and/or penalties, it has been classified in the financial statements as general and administrative expense.

In June 2008, the Internal Revenue Service began its examination of the Company s U.S. federal tax return for the period ended December 31, 2006. The examination is now complete and there were no adjustments.

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

This report contains forward-looking statements regarding Smith Micro Software, Inc. (we, us, our, Smith Micro, or the Company) 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 duration and depth of the current economic slowdown 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, 2008.*

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 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. (we, us, our, Smith Micro, or the Company) designs, develops and markets m software products and services and an extensive line of personal computing graphic and utility software products. We sell our products and services to many of the world s leading wireless mobile operators (carriers & cable), original equipment manufacturers (OEM) Personal Computer (PC) and device manufacturers, enterprise businesses, as well as direct to consumers.

The Company is committed to bringing together innovative solutions from mobile connectivity, to managing media content mobility, and to advancing mobile software management. Smith Micro products enrich people s experience with their computers, mobile devices, and providing access to wireless networks.

The Company is focused on developing mobility solutions that enable seamless broadband connectivity and next-generation multimedia and fixed mobile convergence products over wireless networks. The Company s portfolio

of mobility solutions include the QuickLink® family of client and server products that enable seamless broadband connectivity to manage wireless data communications for 3G and 4G WWAN, WiMAX and WiFi broadband wireless networks, and next generation multimedia products to manage content mobility and fix mobile convergence products for mobile devices and wireless networks. The Company also integrates device management and data compression solutions into both existing connectivity products and standalone product offerings.

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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, WiFi, and WiMAX are combined with new devices such as mobile phones, PCs, Netbooks, Smartphones, and Ultra-Mobile PCs, opportunities emerge for new communications software products. Our core technologies are designed to address these emerging mobile convergence opportunities.

In addition, the Company distributes its product lines and various third-party software products worldwide, direct and through our online stores, third-party wholesalers, retailers and value-added resellers.

We offer software products that operate on Windows, Mac, UNIX, Linux, Windows Mobile, Symbian, and Java platforms. The underlying design concept common across our products is our ability to improve the customer s experience and this philosophy is based on the combination of solid engineering and exceptional design that reinforces our brand s competitive differentiation and customer value. We have over 25 years of experience in design, creation and custom engineering services for software products. We create value by leveraging our business model to build new services and solutions that allow our customers to quickly enter a market with new product offerings that target their customer segments.

On December 10, 2007, Smith Micro entered into an Asset Purchase Agreement with PCTEL, Inc. pursuant to which Smith Micro agreed to acquire substantially all of the assets of PCTEL s Mobility Solutions Group (MSG). Pursuant to the terms of the Asset Purchase Agreement, Smith Micro paid $59.7 million in cash to PCTEL at the closing on January 4, 2008.

Results of Operations

The table below sets forth certain statements of operations data expressed as a percentage of revenues for the three and six months ended June 30, 2009 and 2008. Our historical results are not necessarily indicative of the operating results that may be expected in the future.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	15.1	23.3	17.0	23.3
Gross profit	84.9	76.7	83.0	76.7
Operating expenses:				
Selling and marketing	23.7	24.9	24.9	27.8
Research and development	33.6	33.5	33.8	32.9
General and administrative	17.3	20.3	18.1	21.2
Total operating expenses	74.6	78.7	76.8	81.9
Operating income (loss)	10.3	(2.0)	6.2	(5.2)
Interest and other income	0.5	0.6	0.7	0.9
Profit (loss) before taxes	10.8	(1.4)	6.9	(4.3)
Income tax expense (benefit)	5.9	(0.7)	3.8	(3.2)
Net income (loss)	4.9%	(0.7)%	3.1%	(1.1)%

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. Substantially all of our operations are organized into two business units:

Wireless, which includes our connection manager solutions for the OEM and Enterprise channels, music, photo and video content management, device management; and

Productivity & Graphics, which includes retail sales of our compression and broad consumer-based software.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Wireless	$ 21,373	$ 16,836	$ 40,630	$ 32,992
Productivity & Graphics	4,332	6,220	8,583	11,705
Corporate/Other	281	396	561	635
Total Revenues	25,986	23,452	49,774	45,332
Cost of revenues	3,922	5,463	8,445	10,579
Gross Profit	$ 22,064	$ 17,989	$ 41,329	$ 34,753

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 acquired intangibles. We remain focused on the development and expansion of our technology, particularly our wireless, compression and multimedia software technologies.

General and administrative. General and administrative expenses consist primarily of personnel costs, professional services and fees paid for external service providers, travel, 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. In June 2008, we changed our investment strategy to include short-term investments in equity and debt securities with maturity dates within three to 12 months. 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 under the provision of SFAS No. 109, *Accounting for Income Taxes.* This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in the Company s financial statements or tax returns. 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, SFAS No. 109 requires an evaluation of the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized. Effective January 1, 2007, the Company adopted FIN No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109.* Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements.

Three Months Ended June 30, 2009 Compared to the Three Months Ended June 30, 2008

Revenues. Revenues were $26.0 million and $23.5 million for the three months ended June 30, 2009 and 2008, respectively, representing an increase of $2.5 million, or 10.8%. Wireless sales increased $4.5 million, or 26.9%, primarily due to new connectivity and security product OEM licenses of $7.1 million. These increases were partially offset by a $2.6 million decrease primarily due to the change in how our multimedia products were merchandised by our primary music customers; changing from higher revenue, lower margin music kits (including software, cable and ear buds) to downloadable software or as a software-only CD, resulting in lower revenue per unit, but at a much higher margin per unit. Productivity & Graphics sales decreased $1.9 million, or 30.4%, primarily due to the effect of the worldwide economic downturn. Corporate/Other sales decreased $0.1 million as we have de-emphasized this

business.

Cost of revenues. Cost of revenues were $3.9 million and $5.4 million for the three months ended June 30, 2009 and 2008, respectively, representing a decrease of $1.5 million, or 28.2%. Direct product costs decreased $1.8 million primarily due to a shift in

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product mix. A decrease in sales of lower margin multimedia and productivity and graphics products were more than offset by sales of higher margin OEM license products. Amortization of intangibles increased from $0.9 million to $1.2 million, or $0.3 million, due to several small acquisitions made in the fourth quarter of 2008. Stock-based compensation expense was $0.1 million for both fiscal quarters ended June 30, 2009 and 2008.

Gross profit. Gross profit was $22.1 million, or 84.9% of revenues for the three months ended June 30, 2009, an increase of $4.1 million, or 22.7%, from $18.0 million, or 76.7% of revenues for the three months ended June 30, 2008. The 8.2 percentage point increase was primarily due to improved product margins of 8.7 points as a result of the change in product mix mentioned above, and lower stock-based compensation expense as a percentage of sales of 0.3 points. These items were partially offset by higher amortization of intangibles due to several small acquisitions of 0.8 points.

Selling and marketing. Selling and marketing expenses were $6.1 million and $5.8 million for the three months ended June 30, 2009 and 2008, respectively, representing an increase of $0.3 million, or 5.3%. This increase was primarily due to an increase in personnel costs associated with increased headcount. Stock-based compensation expense was $0.7 million for both fiscal quarters ended June 30, 2009 and 2008. Amortization of intangible assets was $0.6 million for both fiscal quarters ended June 30, 2009 and 2008.

Research and development. Research and development expenses were $8.7 million and $7.8 million for the three months ended June 30, 2009 and 2008, respectively, representing an increase of $0.9 million, or 11.1%. This increase was primarily due to increased personnel and recruiting costs associated with new hired headcount of $1.1 million to support our new product initiatives and new contract wins. This increase was partially offset by lower stock-based compensation expense which decreased from $0.9 million to $0.7 million, or $0.2 million. Amortization of purchased technologies was $0.3 million for both fiscal quarters ended June 30, 2009 and 2008.

General and administrative. General and administrative expenses were $4.5 million and $4.8 million for the three months ended June 30, 2009 and 2008, respectively, representing a decrease of $0.3 million, or 5.4%. This decrease was primarily due lower stock-based compensation expense which decreased from $1.3 million to $1.0 million.

Interest and other income. Interest and other income was $0.1 million for both fiscal quarters ended June 30, 2009 and 2008.

Income tax provision. We recorded an income tax expense for the three months ended June 30, 2009 in the amount of $1.5 million, and a tax benefit of $0.2 million for the three months ended June 30, 2008. The high effective tax rate is due to stock-based compensation book expense which is a permanent difference to taxable income.

Six Months Ended June 30, 2009 Compared to the Six Months Ended June 30, 2008

Revenues. Revenues were $49.8 million and $45.3 million for the six months ended June 30, 2009 and 2008, respectively, representing an increase of $4.4 million, or 9.8%. Wireless sales increased $7.6 million, or 23.2%, primarily due to new connectivity and security product OEM licenses of $14.7 million. These increases were partially offset by a $7.1 million decrease primarily due to the change in how our multimedia products were merchandised by our primary music customers; changing from higher revenue, lower margin music kits (including software, cable and ear buds) to downloadable software or as a software-only CD, resulting in lower revenue per unit, but at a much higher margin per unit. Productivity & Graphics sales decreased $3.1 million, or 26.7%, primarily due to the effect of the worldwide economic downturn. Corporate/Other sales decreased $0.1 million as we have de-emphasized this business.

Cost of revenues. Cost of revenues were $8.5 million and $10.6 million for the six months ended June 30, 2009 and 2008, respectively, representing a decrease of $2.1 million, or 20.2%. Direct product costs decreased $2.5 million primarily due to a shift in product mix. A decrease in sales of lower margin multimedia and productivity and graphics products were more than offset by sales of higher margin OEM license products. Amortization of intangibles increased from $1.8 million to $2.3 million, or $0.5 million, due to several small acquisitions made in the fourth quarter of 2008. Stock-based compensation expense decreased from $0.2 million to $0.1 million, or $0.1 million.

Gross profit. Gross profit was $41.3 million, or 83.0% of revenues for the six months ended June 30, 2009, an increase of $6.6 million, or 18.9%, from $34.7 million, or 76.7% of revenues for the six months ended June 30, 2008. The 6.3 percentage point increase was primarily due to improved product margins of 6.8 points as a result of the change in product mix mentioned above, and lower stock-based compensation expense as a percentage of sales of 0.2

points. These items were partially offset by higher amortization of intangibles due to several small acquisitions of 0.7 points.

Selling and marketing. Selling and marketing expenses were $12.4 million and $12.5 million for the six months ended June 30, 2009 and 2008, respectively, representing a decrease of $0.1 million, or 1.2%. This decrease was primarily due to a lower stock-

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based compensation expense of $0.7 million, decreasing from $2.1 million to $1.4 million. This decrease was partially offset by costs associated with headcount increases of $0.5 million and higher amortization of intangibles of $0.1 million, which increased from $1.2 million to $1.3 million.

Research and development. Research and development expenses were $16.8 million and $14.9 million for the six months ended June 30, 2009 and 2008, respectively, representing an increase of $1.9 million, or 12.8%. This increase was primarily due to increased personnel, recruiting, and overhead costs associated with increased headcount of $2.7 million to support our new product initiatives and new contract wins. This increase was partially offset by lower consulting costs of $0.4 million as these temporary resources were replaced by full-time employees and lower stock-based compensation expense which decreased from $1.7 million to $1.3 million, or $0.4 million. Amortization of purchased technologies was $0.6 million for both six months ended June 30, 2009 and 2008.

General and administrative. General and administrative expenses were $9.0 million and $9.6 million for the six months ended June 30, 2009 and 2008, respectively, representing a decrease of $0.6 million, or 6.4%. Expense decreases were due to overall reduced spending of $0.7 million and lower stock-based compensation expense which decreased from $2.7 million to $2.2 million, or $0.5 million. These expense decreases were partially offset by increased space and occupancy costs of $0.4 million and higher salaries of $0.2 million.

Interest and other income. Interest and other income was $0.4 million for both six months ended June 30, 2009 and 2008.

Income tax provision. We recorded an income tax expense for the six months ended June 30, 2009 in the amount of $1.9 million, and a tax benefit of $1.5 million for the six months ended June 30, 2008. The high effective tax rate is due to stock-based compensation book expense which is a permanent difference to the taxable income.

Liquidity and Capital Resources

At June 30, 2009, we had $43.8 million in cash and cash equivalents and short-term investments and $55.9 million of working capital. On January 4, 2008, we acquired the Mobile Solutions Group of PCTEL at a cost of $59.7 million in cash plus $1.2 million of legal and banking fees which were paid through June 30, 2008. We currently have no significant capital commitments, and currently anticipate that capital expenditures will not vary significantly from recent periods. We believe that our existing cash, cash 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 provided by operating activities was $9.8 million for the six months ended June 30, 2009. The primary sources of operating cash were adjustments for non-cash expenses including depreciation and amortization of $5.0 million, stock-based compensation of $4.6 million, net income and other non-cash expenses of $2.6 million, and increases of current liabilities of $2.0 million. The primary use of cash affecting operating cash flow was an increase in accounts receivable of $4.3 million and the reduction of other assets of $0.1 million. Net cash provided by operating activities was $0.6 million for the six months ended June 30, 2008. The primary sources of operating cash were adjustments for non-cash expenses including stock based compensation of $6.2 million and depreciation and amortization of $3.0 million. The primary use of cash affecting operating cash flow was an increase in accounts receivable of $7.1 million and a reduction of deferred taxes of $1.5 million.

Investing activities

During the six months ended June 30, 2009, we used $10.5 million in investing activities due to investing in short-term investments of $7.2 million and capital expenditures for leasehold improvements, a new phone system, a new ERP system, and other computer equipment of $3.3 million. In the six months ended June 30, 2008, we used $63.9 million in investing activities for the acquisition of the Mobility Solutions Group of PCTEL for $60.9 million, investing in short-term investments of $1.8 million, and capital expenditures of $1.2 million.

Financing activities

We received $0.7 million in cash during the six months ended June 30, 2009; $0.6 million from the exercise of stock options and $0.1 million for tax benefits from stock-based compensation in accordance with SFAS No. 123(R). In the six months ended June 30, 2008, we received $0.1 million primarily from the exercise of stock options.

Contractual obligations and commercial commitments

As of June 30, 2009 we had no debt. The following table summarizes our contractual obligations as of June 30, 2009 (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	$ 8,004	$ 1,557	$ 3,082	$ 1,912	$ 1,453
Purchase Obligations	151	151			
Total	$ 8,155	$ 1,708	$ 3,082	$ 1,912	$ 1,453

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

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 40,000 square feet of space pursuant to leases that expires May 31, 2016. We lease approximately 14,400 square feet in Chicago, Illinois under a lease that expires August 31, 2012. We lease approximately 13,300 square feet in Watsonville, California under a lease that expires September 30, 2013. We lease approximately 7,300 square feet in Herndon, Virginia under a lease that expires November 30, 2009. Internationally, we lease space in Stockholm, Sweden; Belgrade, Serbia; Oslo, Norway; and Vancouver, Canada. These leases are for one to three-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 in accordance with the AICPA Statement of Position (SOP) No. 97-2, *Software Revenue Recognition,* as amended, when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectibility is probable. We recognize revenues from sales of our software to OEM customers or end users as completed products are shipped and titles passes; or from royalties generated as authorized customers duplicate our software, if the other requirements of SOP No. 97-2 are met. If the requirements of SOP No. 97-2 are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. Returns from

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OEM customers are limited to defective goods or goods shipped in error. Historically, OEM customer returns have not exceeded the very nominal estimates and reserves. Management reviews available retail channel information and makes a determination of a return provision for sales made to distributors and retailers based on current channel inventory levels and historical return patterns. Certain sales to distributors or retailers are made on a consignment basis. Revenue for consignment sales are not recognized until sell through to the final customer is established. Within the Productivity & Graphics group certain revenues are booked net of revenue sharing payments, pursuant to the consensus of EITF No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. We have a few multiple element agreements for which we have contracted to provide a perpetual license for use of proprietary software, to provide non-recurring engineering, and in some cases to provide software maintenance (post contract support). For multiple element agreements, vendor specific objective evidence of fair value for all contract elements is reviewed and the timing of the individual element revenue streams is determined and recognized consistent with SOP No. 97-2. Sales directly to end-users are recognized upon delivery. End users have a thirty day right of return, but such returns are reasonably estimable and have historically been immaterial. We also provide technical support to our customers. Such costs have historically been insignificant.

Sales Incentives

Pursuant to the consensus of EITF No. 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Product),* effective January 1, 2002, the cost of sales incentives the Company offers without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction is accounted for as a reduction of revenue. We track incentives by program and use historical redemption rates to estimate the cost of customer incentives. Total sales incentives were $0.6 and $0.3 million for the six months ended June 30, 2009 and 2008, respectively.

Accounts Receivable and Allowance for Doubtful Accounts

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

Internal Software Development Costs

Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. The Company considers technological feasibility to be established when all planning, designing, coding and testing has been completed according to design specifications. After technological feasibility is established, any additional costs are capitalized. Through June 30, 2009, software has been substantially completed concurrently with the establishment of technological feasibility; accordingly, no costs have been capitalized to date.

Capitalized Software and Amortization

Pursuant to the provisions of SFAS No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed,* 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. 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 acquisitions is calculated on a straight line basis over the lives indicated above.

Impairment or Disposal of Long Lived Assets

The Company accounts for the impairment and disposition of long-lived assets in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. This statement addresses financial accounting and reporting for the

impairment of long-lived assets and for the disposal of long-lived assets. In accordance with SFAS No. 144, long-lived assets to be held are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. The Company periodically reviews the carrying value of long-lived assets to determine whether or not impairment to such value has occurred. The Company has determined that there was no impairment at June 30, 2009.

Valuation of Goodwill and Intangible Assets

The Company accounts for goodwill and intangible assets in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. 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.

Deferred Income Taxes

We account for income taxes under SFAS No. 109, *Accounting for Income Taxes*. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in our financial statements or tax returns. The measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and the tax bases of our assets and liabilities result in a deferred tax asset, SFAS No. 109 requires an evaluation of the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized. Effective January 1, 2007, the Company adopted FIN No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*. Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements.

Stock-Based Compensation

We account for stock-based compensation in accordance with SFAS No. 123(R), *Share-Based Payment.* SFAS No. 123(R) requires that share-based payment transactions with employees be recognized in the financial statements based on their fair value and recognized as compensation expense over the vesting period. We adopted SFAS No. 123(R) effective January 1, 2006, prospectively for new equity awards issued subsequent to January 1, 2006.

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 June 30, 2009, the carrying values of our financial instruments approximated fair values based on current market prices and rates.

Foreign Currency Risk

While a majority of our business is denominated in U.S. dollars, we do occasionally invoice in foreign currencies. For the three months ended June 30, 2009 and 2008, our revenues denominated in foreign currencies were $0.3 million and $0.4 million, respectively. For the six months ended June 30, 2009 and 2008, our revenues denominated in foreign currencies were both $0.7 million. Fluctuations in the rate of exchange between the U.S. dollar and certain other currencies may affect our results of operations and period-to-period comparisons of our operating results. We do not currently engage in hedging or similar transactions to reduce these risks. The operational expenses of our foreign entities reduce the currency exposure we have because our foreign currency revenues are offset in part by expenses payable in foreign currencies. As such, we do not believe we have a material exposure to foreign currency rate fluctuations at this time.

Item 4. Controls and Procedures.

Evaluation of disclosure controls and procedures

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 (Exchange Act)) as of June 30, 2009. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have determined that as of June 30, 2009, our disclosure controls and procedures were effective to ensure that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Management s responsibility for financial statements

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

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

Changes in internal control over financial reporting

There have been no changes in our internal control over financial reporting during the quarter ended June 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control 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, 2008. 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.

10.10	Summary of oral agreement dated June 2005 by and between William W. Smith, Jr. and the Registrant.
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.

August 4, 2009	By /s/ William W. Smith, Jr. William W. Smith, Jr. President and Chief Executive Officer *(Principal Executive Officer)*
August 4, 2009	By /s/ Andrew C. Schmidt Andrew C. Schmidt Vice President and Chief Financial Officer *(Principal Financial Officer)*

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