

SMITH MICRO SOFTWARE INC

Form 10-K/A

May 25, 2005

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

FORM 10-K/A

AMENDMENT NO. 2

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

For the fiscal year ended December 31, 2004

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

For the transition period from _____ to _____

Commission File Number 0-26536

SMITH MICRO SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or
organization)

33-0029027

(I.R.S. Employer Identification Number)

51 Columbia, Suite 200, Aliso Viejo, CA

(Address of principal executive offices)

92656

(Zip Code)

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

Common Stock, \$.001 par value

(Title of each class)

Nasdaq SmallCap Market

(Name of each exchange on which registered)

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

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

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

Indicate by check mark if whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). YES NO

As of June 30, 2004, the last business day of the registrant's most recently completed second quarter, the aggregate market value of the common stock of the registrant held by non-affiliates was \$15,151,026 based upon the closing sale price of such stock as reported on the Nasdaq SmallCap Market on that date. For purposes of such calculation, only executive officers, board members, and beneficial owners of more than 10% of the registrant's outstanding common stock are deemed to be affiliates.

As of February 25, 2005, there were 21,536,918 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None.

SMITH MICRO SOFTWARE, INC.

2004 FORM 10-K/A ANNUAL REPORT

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EXPLANATORY NOTE

Smith Micro Software, Inc. (the Company) is filing this Amendment No. 2 to its Form 10-K for the fiscal year ended December 31, 2004 (the Form 10-K), originally filed with the Securities and Exchange Commission on March 31, 2005, and amended by Amendment No. 1 on Form 10-K/A filed on May 2, 2005 (the Amendment No. 1), for the sole purpose of amending and restating the information required under Part III, Items 10, 11 and 13. Item 10 of Part III is being amended and restated solely to correct clerical errors. The Company is also updating the signature page, the Exhibit Index referenced in Item 15 of Part IV and Exhibits 23.1, 31.1, 31.2 and 32.1.

Pursuant to Rule 12b-15 under the Securities Exchange Act of 1934, as amended, the complete text of Items 10, 11 and 13 of Part III and Item 15 of Part IV, as amended and restated, is set forth below. The Company has also reproduced, but not modified or updated, Items 1-4 of Part I, Items 5-9A of Part II and Items 12 and 14 of Part III in this Amendment No. 2. This Amendment No. 2 speaks as of the original filing date of the Form 10-K and reflects only the changes discussed above. No other information included in the Form 10-K as amended by Amendment No. 1, including the information set forth in Part I, Part II, Items 12 and 14 of Part III, the financial statements and the footnotes thereto, has been modified or updated in any way.

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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

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

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

our ability to predict consumer needs, introduce new products, gain broad market acceptance for such products and ramp up manufacturing in a timely manner;

the intensity of the competition and our ability to successfully compete;

the pace at which the market for new products develop;

the response of competitors, many of whom are bigger and better financed than us;

our ability to successfully execute our business plan and control costs and expenses;

our ability to protect our intellectual property and our ability to not infringe on the rights of others;

our depressed market capitalization; and

those additional factors which are listed under the section Risk Factors on page 20 of this report.

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

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PART I

Item 1. BUSINESS

General

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

We manufacture, market and sell value-added wireless connectivity products targeted to the original equipment manufacturers (OEM) market, particularly wireless service providers and mobile phone manufacturers, as well as direct to the consumer. We offer software products for Windows XP, Windows 2000, Windows Me, Windows 98, Windows CE, Pocket PC, Mac, Palm, Unix and Linux operating systems. The underlying design concept is the long-standing Smith Micro criteria of enhancing the out-of-box experience for the customer. Our custom engineering services bring more than 20 years of hardware and software experience, having shipped over 40 million copies of products to OEM s seeking to better market their products by adding product features, customizing existing features and translating applications into additional languages.

During the fourth quarter of 2004, we announced our latest addition to the QuickLink family, namely QuickLink Mobile Enterprise aimed at the corporate marketplace to take advantage of the demand for additional security built into the Enterprise product. This product will ship in the second quarter of 2005. QuickLink Mobile provides notebook users with the ability to easily roam between wireless wide area networks (WWAN) and Wi-Fi hot spots. QuickLink Mobile allows users to seek out and select available hot spots in their area. We currently maintain OEM relationships with many wireless industry companies including: Verizon Wireless, Telus, Audiovox, LGIC and, Kyocera. Smith Micro also offers products in the PC Utility, Fax and eBusiness markets. Smith Micro s complete line of products are available through direct sales and OEMs. Sales to Verizon Wireless amounted to approximately 68.4% of the Company s net revenues for 2004. Sales to Verizon Wireless, Cingular Wireless and Apple Computer amounted to approximately 27.0%, 10.7% and 10.2% of our net revenues for 2003, respectively. Sales to Verizon Wireless and Apple Computer amounted to approximately 19.0% and 10.7% of our net revenues in 2002, respectively.

We also offer professional consulting services that help clients implement web-based projects. An extension of this activity includes the offering of fulfillment services for customer web stores.

We currently operate in two business segments: products and services. We do not separately allocate operating expenses to these segments, nor do we allocate specific assets to these segments. Therefore, segment information reported includes only revenues and cost of revenues. See Note 7 of Notes to Consolidated Financial Statements for financial information related to our operating segments.

Research and development expenses amounted to \$2.6 million, \$2.5 million and \$2.2 million for the years ended December 31, 2004, 2003 and 2002, respectively. Our research and development expenses consist primarily of personnel and equipment costs required to conduct our software development efforts. We remain focused on the

development and expansion of our technology, particularly our wireless, diagnostic, utility and Internet software technologies.

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

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

Industry Backgrounds

Wireless Industry The evolving types of wireless infrastructures being implemented, such as 1xRTT, GPRS and the emerging 3G offer wider bandwidth data services. Wireless platforms include the basic cellular phone, personal computing devices (PC s) and personal communications devices including PDA s and handheld s. The adoption of these new mobile and wireless communications services provides opportunities for new communications software products.

Diagnostic/Utility Software Industry - Diagnostic and utility software products assist home or corporate users, and hardware manufacturers or service companies to identify and repair computer system related errors and problems.

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

Products and Services

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

Software Products

QuickLink® Mobile	Turns data capable wireless phones into wireless modems.
QuickLink® Mobile Phonebook	Enables users to be able to easily edit wireless phonebooks on a PC computer and copy, email or PIM databases to the phone.
FAXstf® X & FAXstf® X Pro	Enables users to exchange faxes and data files with remote modems, fax/modems, and fax machines quickly and easily on the Mac OS X operating environment.
HotFax® MessageCenter And HotFax®	An integrated voice, fax and data communication software program that lets users receive voice mail and exchange faxes and data files with remote modems, fax/modems, and fax machines quickly and easily.

WebDNA [®]	Provides the tools necessary to develop a Web site or an eBusiness site supporting Windows, Mac, Unix and Linux. Wireless WebDNA [®] is an additional function that can be added to a Web site built using WebDNA [®] that enables WAP capability.
CheckIt [®] Utilities	Provides end-users the hardware information they need to evaluate, fine-tune and manage their systems.

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Services

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

Sales and Marketing

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

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

The cycle from the placement of an OEM order to shipping is very short. OEM customers generally operate under a just-in-time system, and we typically ship our products as we receive orders. A percentage of our OEM revenue is derived from royalties accrued by customers that are authorized to replicate or to preload our software products.

Our three largest OEM customers (Verizon Wireless, Kyocera Wireless and Symantec in 2004), and their respective affiliates, in each year, have accounted for 77.8% of our net revenue in 2004, 47.9% of our net revenues in 2003 and 39.4% of our net revenues in 2002. Our major customers could reduce their orders of our products in favor of a competitor's product or for any other reason. The loss of any of our major OEM customers, decisions by a significant OEM customer to substantially reduce purchases or our inability to collect receivables from these customers could have a material adverse effect on our business.

We traditionally have relatively little backlog for our OEM products at any given time, and we have not considered backlog to be a significant indicator of future performance. As of December 31, 2004, however, we had reported a backlog of \$1 million resulting from orders placed late in the fourth quarter but not shipped. Since we generally do not produce software in advance of anticipated orders, our revenues in any quarter are substantially dependent on orders booked in that quarter.

We sell product directly to retail customers. During the period 2002 through 2004, the retail product sales mix has changed as the result of a reduced emphasis on the retail channel and a renewed focus on our OEM and direct sales as we exited the distribution channel.

Our consulting service group assists customers in deploying and using computer operating systems, applications, and communications products. This group is a part of our Internet & Direct unit and helps create enterprise-wide

computing solutions for large corporate accounts.

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Customer Service and Technical Support

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

Product Development

The software industry, particularly the wireless market, is characterized by rapid and frequent changes in technology and user needs. We work closely with industry groups and customers, both current and potential, to help us anticipate changes in technology and determine future customer needs. Software functionality depends upon the capabilities of the hardware. Accordingly, we maintain engineering relationships with various hardware manufacturers and we develop our software in tandem with their development. Our engineering relationships with manufacturers, as well as with our major customers, are central to our product development efforts. We remain focused on the development and expansion of our technology, particularly in the wireless space. Research and development expenditures amounted to \$2.6 million, \$2.5 million and \$2.2 million for the years ended December 2004, 2003 and 2002, respectively.

Manufacturing

Our software is sold in several forms. We offer a package or kit that may include: CD-ROM(s) for product and hardware-specific drivers; a cable; a manual; and certain other documentation or marketing material. We offer software on CD-ROMs. We also permit selected OEM customers to duplicate our products on their own CD-ROMs and pay a royalty based on usage. This method of sale does not require us to provide a CD or manual. Finally, we grant licenses to certain OEM customers that enable those customers to preload a copy of our software onto a personal computer's hard drive. With the corporate sales program, we offer site licenses under which a corporate user is allowed to distribute copies of the software to users within the corporate sites.

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

Competition

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

We believe that the principal competitive factors affecting the communication software market include: product features, ease of use, customization to customer-specific needs, product quality, price, customer service and effective sales and marketing efforts. Although we believe that our products currently compete favorably with respect to these factors, there can be no assurance that we can maintain our competitive position against current and potential competitors. We believe that the market for our software products has been and will continue to be characterized by significant price competition. A material reduction in the price of our products could negatively affect our

profitability. We face competition from Microsoft due to its market dominance and the fact that it is the publisher of the most prevalent personal computer operating system, Windows. Microsoft represents a significant competitive threat to all personal computer software vendors, including us.

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

Proprietary Rights and Licenses

Our success and ability to compete is dependent upon our software code base, our programming methodologies and other intellectual properties. To protect our proprietary technology, we rely on a combination of trade secrets, nondisclosure and patent, copyright and trademark law that may afford only limited protection. As of December 31, 2004, four currently effective U.S. patents have been issued since December 1997 and three patent applications are currently pending. These patents provide generalized protection to our intellectual property base, and we will continue to apply for various patents and trademarks in the future.

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

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

Employees

As of December 31, 2004, we had a total of fifty-two employees: twenty-seven engaged in engineering; nine in sales and marketing; eight in management and administration; four in customer support; and four in manufacturing. We utilize temporary labor to assist during peak periods of manufacturing volume. We believe that our future success will depend in large part upon our continuing ability to attract and retain highly skilled managerial, sales, marketing, customer support, research and development personnel and consulting staff. Like other software companies, we face intense competition for such personnel, and we have at times experienced and continue to experience difficulty in recruiting qualified personnel. There can be no assurance that we will be successful in attracting, assimilating and retaining other qualified personnel in the future. We are not subject to any collective bargaining agreement and we believe that our relationships with our employees are good.

Item 2. PROPERTIES

Our corporate headquarters, including our principal administrative, sales and marketing, customer support and research and development facility, is located in Aliso Viejo, California, where we currently lease and occupy

approximately 23,500 square feet of space pursuant to a lease that expires May 31, 2009. We operate both our products and services reporting segments within this facility.

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We also have a facility of approximately 1,000 square feet in Lees Summit, Missouri, pursuant to a lease that expires June 14, 2005. During 2003, we terminated leases in San Diego, California and Beaverton, Oregon.

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

Item 3. LEGAL PROCEEDINGS

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

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

There were no matters submitted to a vote of stockholders during the quarter ended December 31, 2004.

PART II

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

Market Information

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

	High	Low
YEAR ENDED DECEMBER 31, 2004:		
First Quarter	\$ 3.66	\$ 2.00
Second Quarter	3.31	1.80
Third Quarter	5.50	1.28
Fourth Quarter	11.20	3.27