SMITH MICRO SOFTWARE, INC.
Form 10-K
March 27, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number 01 35525

SMITH MICRO SOFTWARE, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 33-0029027 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |
| 5800 Corporate Drive, Pittsburgh, PA | 15237 |
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone number, including area code: (412) 837-5300

Securities registered pursuant to Section 12(b) of the Act:

| | |
|---|---|
| Common Stock, $.001 par value | The NASDAQ Stock Market LLC |
| (Title of each class) | (Name of each exchange on which registered) |

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 YES NO

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). 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 a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See definition of “accelerated filer”, “large accelerated filer”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | Smaller reporting company |
| Emerging growth company | |

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

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

As of June 30, 2018, 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 $44,035,963 based upon the closing sale price of such stock as reported on the Nasdaq Capital 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 March 21, 2019, there were 32,165,696 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s Proxy Statement for the 2019 Annual Meeting of Stockholders to be filed under the Securities Exchange Act of 1934 are incorporated by reference in Part III of this report.

SMITH MICRO SOFTWARE, INC.

2018 ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS


| | | |
|---|---|---|
| | PART I | |
| Item 1. | BUSINESS | 5 |
| Item 1A. | RISK FACTORS | 10 |
| Item 1B. | UNRESOLVED STAFF COMMENTS | 18 |
| Item 2. | PROPERTIES | 19 |
| Item 3. | LEGAL PROCEEDINGS | 19 |
| Item 4. | MINE SAFETY DISCLOSURES | 19 |
| | PART II | |
| Item 5. | MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES | 20 |
| Item 6. | SELECTED CONSOLIDATED FINANCIAL DATA | 22 |
| Item 7. | MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS | 24 |
| Item 8. | FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA | 33 |
| Item 9. | CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE | 33 |
| Item 9A. | CONTROLS AND PROCEDURES | 33 |
| Item 9B. | OTHER INFORMATION | 34 |
| | PART III | |
| Item 10. | DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE | 35 |
| | EXECUTIVE COMPENSATION | 35 |

| | | |
|---|---|---|
| Item 11. | | |
| Item 12. | SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS | 35 |
| Item 13. | CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE | 35 |
| Item 14. | PRINCIPAL ACCOUNTING FEES AND SERVICES | 35 |
| | PART IV | |
| Item 15. | EXHIBITS | 36 |
| Item 16. | FORM 10-K SUMMARY | 41 |
| | SIGNATURES | 42 |

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

This Annual Report on Form 10-K (this “Report”) contains forward-looking statements regarding Smith Micro which include, but are not limited to, statements concerning customer concentration, projected revenues, market acceptance of products, the success and timing of new product introductions, the competitive factors affecting our business, our ability to raise additional capital, gross profit and income, our ability to remain a going concern, our expenses, 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 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 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:

- our customer concentration given that the majority of our sales currently depend on a few large client relationships, including Sprint;
- our ability to establish and maintain strategic relationships with our customers and mobile device manufacturers;
- rapid technological evolution and resulting changes in demand for our products from our key customers and their end users;
- intense competition in our industry and the core vertical markets in which we operate, and our ability to successfully compete;
    - our ability to assimilate acquisitions without diverting management attention and impacting current operations;
- our ability to raise additional capital and the risk of such capital not being available to us at commercially reasonable terms or at all;
- our ability to hire and retain key personnel;
- interruptions or delays in the services we provide from our data center hosting facilities that could harm our business;
- the possibility of security and privacy breaches in our systems damaging client relations and inhibiting our ability to grow;
- our ability to become and remain profitable;
- our ability to remain a going concern;
- the risk of being delisted from NASDAQ if we fail to meet any of its applicable listing requirements;
- the availability of third-party intellectual property and licenses needed for our operations on commercially reasonable terms, or at all;
- changes in our operating income or loss due to shifts in our sales mix and variability in our operating expenses;
- the difficulty of predicting our quarterly revenues and operating results and the chance of such revenues and results falling below analyst or investor expectations, which could cause the price of our common stock to fall;
- potential tax liabilities and other factors that may impact our effective tax rates;
- the existence of undetected software defects in our products;

- the impact of evolving information security and data privacy laws on our business and industry;
- the impact of U.S. regulations on our business and industry;
- our ability to protect our intellectual property and our ability to operate our business without infringing on the rights of others;
- the risks inherent with international operations; and
- those additional factors which are listed under Item 1A of Part I of this Report under the caption "RISK FACTORS."

The forward-looking statements contained in this Report are made on the basis of the views and assumptions of management regarding future events and business performance as of the date this Report is filed with the Securities and Exchange Commission (the "SEC"). In addition, we operate in a highly competitive and rapidly changing environment; therefore, new risk factors can arise, and it is not possible for management to predict all such risk factors, nor to assess the impact of all such risk factors on our business or the extent to which any individual risk factor, or combination of risk factors, may cause results to differ materially from those contained in any forward-looking statement. We do not undertake any obligation to update these statements to reflect events or circumstances occurring after the date this Report is filed.

PART I

Item 1. BUSINESS

General

Smith Micro develops software to simplify and enhance the mobile experience, providing solutions to some of the leading wireless service providers and cable multiple service operators ("MSOs") around the world. From enabling the family digital lifestyle to providing powerful voice messaging capabilities, our solutions enrich today's connected lifestyles while creating new opportunities to engage consumers via smartphones and consumer devices for the Internet of Things ("IoT"). Our portfolio also includes a wide range of products for creating, sharing and monetizing rich content, such as visual messaging, optimizing retail content display, analytics capabilities, and 2D/3D graphics applications.

In general, we offer our customers:

- Valuable digital services for the connected digital lifestyle, including family location and parental controls, as well as enabling connected family and consumer IOT devices to mobile consumers worldwide;
- Easy visual access to wirelessly delivered voicemail messages, while also providing easy conversion of voice messages to text and email messages;
- Efficient, consistent and measurable retail content that educates consumers, creates awareness of products and services and drives in store sales;
- Optimized wireless networks, reduced operational costs, and "best-connected" user experiences; and
- The ability to design and create 2D and 3D digital illustrations, animation and figure design with easy-to-use, professional-grade graphics software.

We continue to innovate and evolve our business to take advantage of industry trends and opportunities in emerging markets, such as digital lifestyle services and online safety, "Big Data" analytics, automotive telematics, and the consumer IoT marketplace. The key to our longevity, however, is not simply technological innovation, but a never-ending focus on customer value.

During fiscal year 2018, we built on the steps taken throughout the prior year to improve operations and overall execution of our business, moving to growth and profitability. We stabilized and significantly strengthened our balance sheet during the year with three private placement transactions, which allowed us to repay certain short and long-term debt obligations and allowed us the flexibility to execute on other strategic initiatives. In December 2018, we entered into an asset purchase agreement for our acquisition of substantially all of the assets of the smart retail product suite of ISM Connect, LLC. The acquisition closed in January 2019, and the acquired product suite fits strategically within our wireless business.

The Company was incorporated in California in November 1983, and reincorporated in Delaware in June 1995. Our principal executive offices are now located at 5800 Corporate Drive, Pittsburgh, Pennsylvania 15237, after recently moving from our California location. Our telephone number is (412) 837-5300. Our website address is www.smithmicro.com, and we make our filings with the U.S. Securities and Exchange Commission (the "SEC") available on the Investor Relations page of our website. Information contained on our website does not constitute a part of this Report. Our common stock is traded on the NASDAQ under the symbol "SMSI".

Business Segments

Our business is focused on two industry segments: Wireless and Graphics. We do not separately allocate operating expenses, nor do we allocate specific assets to these segments. Therefore, segment information reported includes only revenues. See Note 13 of the Notes to Consolidated Financial Statements for financial information related to our business segments and geographical information.

5

Wireless Segment

The wireless industry continues to undergo rapid change on all fronts, as connected devices, mobile applications, and digital content are consumed by users who want information, high-speed wireless connectivity, and entertainment anytime, anywhere. While most of us think about being "connected" in terms of computers, tablets and smartphones, the consumer IoT market is creating a world where almost anything can be connected to the wireless internet. Wearable devices such as smartwatches, smart home devices, fitness trackers, pet trackers and GPS locators are now commonplace, enabling people and pets to be connected to the "Internet of Everything" as well. These devices have created an entire ecosystem of over-the-top ("OTT") apps, while expanding how communication service providers can provide value to mobile consumers.

Although there are numerous business opportunities associated with pervasive connectivity, there are also numerous challenges, including:

- The average age by which most children use smartphones and other connected devices continues to decrease. As such, parents and guardians must be proactive in managing and combating digital lifestyle problems such as excess screen time, cyberbullying, and online safety;
- Complexity, congestion, and spectrum scarcity plague wireless networks, making it difficult and expensive to satisfy the demand for mobile services by consumers and businesses;
- As IoT use cases continue to proliferate and scale, management complexity, security and interoperability must be addressed efficiently and correctly;
- Mobile Network Operators ("MNOs") are being marginalized by messaging applications, and face growing competitive pressure from cable MSOs and others deploying Wi-Fi networks to attract mobile users;
- Enterprises face increasing pressure to mobilize workforces, operations, and customer engagement, but lack the expertise and technologies needed to leverage mobile securely and cost-effectively; and
- Consumers, frustrated by slow, congested mobile networks and inconsistent device/app behavior, seek simpler network access and more personalized mobile experiences, while simultaneously demanding faster, cheaper, and more secure wireless services.

To address these challenges, Smith Micro offers multi-platform, modular solutions such as:

SafePath® – The SafePath platform delivers a connected life experience for families and the connected devices that are part of their daily digital lifestyle inside and outside the home. The SafePath platform includes SafePath Family – enabling mobile service providers to meet the needs of their customers for family real time location, protection and parental controls services – and SafePath IoT – allowing service providers to deliver a connected digital life experience to their customers by bringing all of their connected devices like child and elderly wearable locators, pet trackers, car trackers, and connected home security devices under a single pane of glass.

CommSuite® – Smith Micro's CommSuite premium messaging platform helps MNOs deliver a next-generation voicemail experience to mobile subscribers, while enabling them to monetize a legacy cost-center. CommSuite Visual Voicemail ("VVM") quickly and easily allows users to manage voice messages just like email or SMS – with reply, forwarding and social sharing options. CommSuite also enables multi-language Voice-to-Text ("VTT") transcription messaging, which facilitates convenient message consumption for users by reading versus listening. In 2018, the CommSuite product was installed on more than 18 million mobile handsets and is available to both postpaid premium subscribers as well as prepaid subscribers.

ViewSpot™ – Our recently acquired smart retail platform provides wireless carriers and retailers with a way to bring powerful on-screen, interactive demos to life. These engaging demos deliver consistent, secure and targeted content that showcases the features of the devices that consumers want to see and learn more about. The ViewSpot platform also offers analytics capabilities for carriers to gain valuable insights into their consumer base and its buying behavior as well as their retail operations.

NetWise® – NetWise is a policy-on-device platform that optimizes wireless Quality of Experience (“QoE”). Addressing challenges central to today's mobile lifestyle such as connection and network traffic management, Wi-Fi discovery, credential provisioning, user authentication and radio management, NetWise is a proven carrier-grade solution for communications service providers (“CSP”).

For over 35 years, Smith Micro has provided software solutions for global businesses, evolving with the telecom industry through the Internet age. Today, we develop wireless standards-based software that is extensible, interoperable, scalable, and proven to meet the most dynamic and demanding mobile environments.

Graphics Segment

Smith Micro’s graphics group develops a variety of software, including graphic design and animation, and compression and PC/Mac utilities, for consumers, professional artists, and educators. These products are available through direct sales on Smith Micro websites (smithmicro.com and mysmithmicro.com), as well as through affiliate websites, resellers, and retail outlets.

The Company’s graphics portfolio includes Poser®, a professional solution for 3D Figure Design and Animation; Moho® (formerly Anime Studio®), a complete solution for 2D animation; and MotionArtist®, an easy-to-use tool that enables amateur and professional artists to bring comics to life with animated panels, text and word balloons. These programs are used by major entertainment studios, and world-renowned artists and graphics firms to create award-winning movies, television shows, TV advertising, internet media content, 3D gaming, and visual designs. During 2018, Smith Micro added additional products to its portfolio through exclusive distribution agreements. Chief among these are Rebelle, a unique digital painting solution for creating realistic art using watercolors, acrylics, and any wet and dry media, and PhotoDonut, a powerful tool for creating artistic effects on any digital image using one of the hundreds of pre-built styles, or creating your own.

Products

Our primary products consist of the following:

| Business Segment | Products | Description |
|---|---|---|
| Wireless | SafePath® Family | A platform that enables mobile service providers to meet the needs of their customers for family real time location, protection and parental controls services. |
| | SafePath® IoT | A platform that enables service providers to deliver a connected digital life experience to their customers by bringing all of their connected devices like child and elderly wearable locators, pet trackers, car trackers, and connected home security devices under a single pane of glass. |
| | CommSuite® VVM | Visual Voicemail delivered directly to a mobile phone app and managed like email available to both postpaid and prepaid subscribers. |
| | CommSuite® VTT | Voice-to-Text transcription of voicemail and voice SMS messages. |
| | ViewSpot™ | A smart retail platform that provides wireless carriers and retailers with a way to bring powerful on-screen, interactive demos to life, delivering consistent, secure and targeted content that showcases the features of the devices that consumers want to see and learn more about. Also offers analytics capabilities for carriers to gain valuable insights into their consumer base and its buying behavior as well as their retail operations. |
| | NetWise® Optics | A mobile analytics solution that uncovers performance blind spots in wireless networks and helps CSPs optimize network quality and performance. |
| | NetWise® Passport | An automated user onboarding and Wi-Fi service provisioning solution. |
| Graphics | Poser® | 3D rendering and animation software for photorealistic characters, art, illustration, and digital design. |
| | Moho® (formerly Anime Studio®) | Complete 2D animation program for creating movies, cartoons, anime, and cut out animations. |
| | PhotoDonut | A powerful software tool for creating artistic effects on any digital image using one of the hundreds of pre-built styles, or creating your own. |
| | Rebelle | A unique digital painting solution for creating realistic art using watercolors, acrylics, and any wet and dry media. |

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|---|---|
| MotionArtist® | A fast, easy solution for creating animatics and interactive presentations. |
| StuffIt Deluxe® | A patented, lossless compression solution for documents and media. |

Marketing and Sales Strategy

Because of our broad product portfolio, deep integration experience, and flexible business models, we can quickly bring to market innovative solutions that support our customers' needs to create new revenue opportunities and differentiate their products and services among their competitors.

Our marketing and sales strategy is as follows:

Leverage Operator Relationships. We continue to capitalize on our strong relationships with the world's leading MNOs and MSOs. These customers serve as our primary distribution channel, providing access to hundreds of millions of end users around the world.

Focus on High-Growth Markets. We continue to focus on providing digital lifestyle solutions, analytics/Big Data solutions, premium messaging services, and visual retail content marketing solutions.

Expand our Customer Base. In addition to growing our business with current customers, we look to expand our carrier and MSO customers worldwide, as well as to expand into new partnerships as we extend the reach of our product platforms within the connected lifestyle ecosystem.

Key Revenue Contributors

Revenues attributable to Sprint and their respective affiliates in the Wireless business segment accounted for 81% and 61% of the Company's total revenues for fiscal years 2018 and 2017, respectively. Revenues attributable to FastSpring in the Graphics business segment accounted for 5% and 14% of the Company's total revenues for fiscal years 2018 and 2017, respectively. The loss of any of our major customers or decisions by a significant customer to substantially reduce purchases from us for any reason could have a material adverse effect on our business.

Customer Service and Technical Support

We provide technical support and customer service through our online knowledge base, email, and live chat. OEM customers generally provide their own primary customer support functions and rely on us for support to their technical support personnel.

Product Development

The software industry, particularly the wireless market, is characterized by rapid and frequent changes in technology and user needs. We work closely with industry groups and customers, both current and potential, to help us anticipate changes in technology and determine future customer needs. Software functionality depends upon the capabilities of the hardware. Accordingly, we maintain engineering relationships with various hardware manufacturers and we develop our software in tandem with their product development. Our engineering relationships with manufacturers, as well as with our major customers, are central to our product development efforts. We remain focused on the development and expansion of our technology, particularly in the wireless space. Research and development expenditures amounted to $8.6 million and $9.0 million for the years ended December 31, 2018 and 2017, respectively.

Competition

The markets in which we operate are highly competitive and subject to rapid changes in technology. These conditions create new opportunities for Smith Micro, as well as for our competitors, and we expect new competitors to continue to enter the market. We not only compete with other software vendors for new customer contracts, we also compete to acquire technology and qualified personnel.

We believe that the principal competitive factors affecting the mobile software market include domain expertise, product features, usability, quality, price, customer service, and effective sales and marketing efforts. Although we believe that our products currently compete favorably with respect to these factors, there can be no assurance that we can maintain our competitive position against current and potential competitors. We also 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 we obtain for our products would negatively affect our profitability.

Many of our existing and potential customers have the resources to develop products that compete directly with our products. As such, these customers may opt to discontinue the purchase of our products in the future. With this as background, our future performance is substantially dependent upon the extent to which existing customers elect to purchase software from us rather than designing and developing their own software.

Proprietary Rights and Licenses

We protect our intellectual property through a combination of patents, copyrights, trademarks, trade secrets, foreign intellectual property laws, confidentiality procedures and contractual provisions. We have United States and foreign patents and pending patent applications that relate to various aspects of our products and technology. We have also registered, and applied for the registration of, U.S. and international trademarks, service marks, domain names, and copyrights. We will continue to apply for such protections in the future as we deem necessary to protect our intellectual property. We seek to avoid unauthorized use and disclosure of our proprietary intellectual property by requiring employees and third parties with access to our proprietary information to execute confidentiality agreements with us and by restricting access to our source code.

Our wireless customers license our products through software license agreements or access our offerings through software as a service (“SaaS”) agreements, and our graphics products are subject to “click-through” end user license agreements. Our license agreements contain restrictions on reverse engineering, duplication, disclosure, and transfer, and our SaaS agreements contain restrictions on access and use.

Despite our efforts to protect our proprietary technology and our intellectual property rights, unauthorized parties may attempt to copy or obtain and use our technology to develop applications with the same functionality as our applications. Policing unauthorized use of our technology and intellectual property rights is difficult, and we may not be able to detect unauthorized use of our intellectual property rights or take effective steps to enforce our intellectual property rights.

Employees

As of December 31, 2018, we had a total of 153 employees within the following departments: 97 in engineering, 25 in sales and marketing, 10 in operations and customer support, and 21 in management and administration. We are not subject to any collective bargaining agreement and we believe that our relationships with our employees are good.

Item 1A. RISK FACTORS

Our future operating results are highly uncertain. Before deciding to invest in our common stock or to maintain or change your investment, you should carefully consider the risks described below, in addition to the other information contained in this Report and in our other filings with the SEC, including our other Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business operations. If any of these risks actually occur, our business, financial condition or results of operations could be seriously harmed. In that event, the market price for our common stock could decline and you may lose all or part of your investment.

We derive a significant portion of our revenues from sales to a concentrated number of clients, and a reduction in sales to any of them may adversely impact our revenues and operating results.

In our Wireless business segment, we sell primarily to large wireless carriers, cable operators, and OEMs, so there are a limited number of actual and potential customers for our products, resulting in significant customer concentration. For the year ended December 31, 2018, sales to Sprint and their affiliates comprised 81% of our total revenues.

Because of our relatively high customer concentration, a small number of significant customers possess a relative level of pricing and negotiating power over us, enabling them to achieve advantageous pricing and other contractual terms, including the ability to terminate their agreements with us with a limited amount of notice. Any material decrease in our sales to any of these customers would materially affect our revenue and profitability.

Sprint Corporation and T-Mobile (US), Inc. ("T-Mobile") have announced that they have entered into a business combination agreement and that they expect the transaction will be completed during the first half of 2019, with the combined company continuing to operate as T-Mobile. In the event that the combined company does not elect to continue using the solutions that we currently deliver to Sprint, or that our sales to the combined company materially decrease as compared with our sales to Sprint, our revenues and profitability would be materially and adversely affected.

If there are delays in the distribution of our products or if customer negotiations for our new products cannot occur on a timely basis, we may not be able to generate revenues sufficient to meet the needs of the business in the foreseeable future or at all.

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

We sell our wireless products for use on handheld devices primarily to our carrier, cable/MSO, and enterprise customers, who deploy our products for use by their end user customers. The success of our carrier, cable/MSO and enterprise customers, and their ability and willingness to market services to their end users that are supported by our products, is critical to our future success. Our ability to generate revenues from sales of our software is also constrained by our carrier customers' ability to attract and retain customers. We have no input into or influence upon their marketing efforts and sales and customer retention activities. If our large carrier customers fail to maintain or grow demand for their services, revenues or revenue growth from our products designed for use on mobile devices will decline and our results of operations will suffer.

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

Our success depends on our ability to anticipate and adapt to changes in technology and industry standards. We will also need to continue to develop and introduce new and enhanced products to meet our target markets' changing demands and keep up with evolving industry standards, including changes in the Microsoft, Google, and Apple operating systems with which our products are designed to be compatible, and to promote those products successfully. The communications and graphics software markets in which we operate are characterized by rapid technological change, changing customer needs, frequent new product introductions, evolving industry standards, and short product life cycles. In addition, some of the technology we market, which has been sold as software in the past, can be integrated at the chipset level by the leading mobile chipset manufacturers. In addition, new products and product enhancements can require long development and testing periods as a result of the complexities inherent in today's computing environments and the performance demanded by customers and called for by evolving wireless networking technologies. Any of these factors could render our existing products obsolete and unmarketable. If our target markets do not develop as we anticipate, our products do not gain widespread acceptance in these markets, or we are unable to develop new versions of our software products that can operate on future wireless networks and PC and mobile device operating systems and interoperate with other popular applications, our business, financial condition and results of operations could be materially and adversely affected.

We derive a significant portion of our revenues from only a few core vertical markets, and changes within these vertical markets, or failure to penetrate new markets, could adversely impact our revenues and operating results.

We derive a significant portion of our revenue from a few vertical markets, such as wireless carriers, cable operators, and handset manufacturers. In order to sustain and grow our business, we must continue to sell our software products in these vertical markets. Shifts in the dynamics of these vertical markets, such as new product introductions by our competitors, could materially harm our results of operations, financial condition and prospects. Increasing our sales outside our core vertical markets to markets in which we do not have significant experience, for example to large enterprises, would require us to devote time and resources to hire and train sales employees familiar with those

industries. Even if we are successful in hiring and training sales teams, customers in other vertical markets may not need or sufficiently value our current products or new product introductions.

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

We operate in markets that are extremely competitive and subject to rapid changes in technology. Because there are low barriers to entry into the software markets in which we participate and may participate in the future, we expect significant competition to continue from both established and emerging software companies, domestic and international. In fact, our growth opportunities in new product markets could be limited to the extent established and emerging software companies enter or have entered those markets.

Many of our other current and prospective competitors have significantly greater financial, marketing, service, support, technical, and other resources than we do. As a result, they may be able to adapt more quickly than we can to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products. Announcements of competing products by competitors could result in the cancellation of orders by customers in anticipation of the introduction of such new products. In addition, some of our competitors are currently making complementary products that are sold separately. Such competitors could decide to enhance their competitive position by bundling their products to attract customers seeking integrated, cost-effective software applications. Some competitors have a retail emphasis and offer OEM products with a reduced set of features. The opportunity for retail upgrade sales may induce these and other competitors to make OEM products available at their own cost or even at a loss. We also expect competition to increase as a result of software industry consolidations, which may lead to the creation of additional large and well-financed competitors. Increased competition is likely to result in price reductions, fewer customer orders, reduced margins, and loss of market share.

Our acquisitions of companies or technologies may disrupt our business and divert management attention and cause our other operations to suffer.

We have historically made targeted acquisitions of smaller companies or product lines with technology important to our business strategy and expect to continue to do so in the future. Most recently, we acquired our smart retail business, known as ViewSpot. As part of this and any acquisition, we will be required to assimilate the operations, products, and personnel of the acquired businesses and train, retain, and motivate key personnel from the acquired business. We may not be able to maintain uniform standards, controls, procedures and policies if we fail in these efforts. Additionally, as we integrate any newly acquired business into our existing operations, process changes may result in unanticipated or unintended delays in sales of acquired products or services, which could adversely affect our relationships with customers of the acquired business and result in lower revenues from the acquired business than anticipated. Acquisitions may cause disruptions in our operations and divert management’s attention from our Company’s day-to-day operations, which could impair our relationships with our existing employees, customers, and strategic partners. Acquisitions may also subject us to liabilities and risks that are not known or identifiable at the time of the acquisition.

We may also have to incur debt or issue equity securities in order to finance future acquisitions. Our financial condition could be harmed to the extent we incur substantial debt or use significant amounts of our cash resources in acquisitions. The issuance of equity securities for any acquisition could be substantially dilutive to our existing stockholders. In addition, we expect our profitability could be adversely affected because of acquisition-related accounting costs, write offs, amortization expenses, and charges related to acquired intangible assets. In consummating acquisitions, we are also subject to risks of entering geographic and business markets in which we have had limited or no prior experience. If we are unable to fully integrate acquired businesses, products, or technologies within existing operations, we may not receive the intended benefits of such acquisitions.

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

We believe that our cash and the cash we expect to generate from operations will be sufficient to meet our capital needs for the next twelve months. However, it is possible that we may need or choose to obtain additional financing to fund our future activities. We could raise these funds by selling more stock to the public or to selected investors, or by borrowing money. We may not be able to obtain additional funds on favorable terms, or at all. If adequate funds are not available, we may be required to curtail our operations or other business activities significantly or to obtain

funds through arrangements with strategic partners or others that may require us to relinquish rights to certain technologies or potential markets.

It is possible that our future capital requirements may vary materially from those currently anticipated. The amount of capital that we will need in the future will depend on many factors, including but not limited to:

- the market acceptance of our products;
- the levels of promotion and advertising that will be required to launch our products and achieve and maintain a competitive position in the marketplace;
- our business, product, capital expenditure, and research and development plans and product and technology roadmaps;
- the levels of working capital that we maintain;
- capital improvements to new and existing facilities;
- technological advances;
- our competitors' response to our products; and
- our relationships with suppliers and customers.

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

If we are unable to retain key personnel, the loss of their services could materially and adversely affect our business, financial condition and results of operations.

Our future performance depends in significant part upon the continued service of our senior management and other key technical personnel. We do not have employment agreements with our key employees. The loss of the services of our key employees would materially and adversely affect our business, financial condition and results of operations. Our future success also depends on our ability to continue to attract, retain, and motivate qualified personnel, particularly highly skilled engineers involved in the ongoing research and development required to develop and enhance our products. Competition for these employees remains high and employee retention is a common problem in our industry. Our inability to attract and retain the highly trained technical personnel that are essential to our product development, marketing, service, and support teams may limit the rate at which we can generate revenue, develop new products or product enhancements and generally would have an adverse effect on our business, financial condition and results of operations.

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

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

Security and privacy breaches may harm our business.

The uninterrupted operation of our hosted solutions and the confidentiality and security of third-party information and materials is critical to our business. Any failures in our security and privacy measures, such as "hacking" of our systems by outsiders or the inadequate protection of pre-release mobile devices in our custody, could have a material adverse effect on our financial position and results of operations. If we are unable to protect, or our customers and mobile device manufacturer partners perceive that we are unable to protect, the security and privacy of information and materials in our care, our growth could be materially adversely affected and we could be subject to material liability. A security or privacy breach may:

• cause our customers to lose confidence in our solutions;

- cause our mobile device manufacturer partners to cease doing business with us;
- harm our reputation;
- expose us to material liability; and
- increase our expense from potential remediation costs.

While we believe we use proven applications and have established adequate safeguards designed for facility security, data security and integrity to process electronic transactions, there can be no assurance that these applications and safeguards will be adequate to prevent a security breach or to address changing market conditions or the security and privacy concerns of existing and potential customers and device manufacturer partners. In addition, our customers and end users may use our products and services in a manner which violates security or data privacy laws in one or more jurisdictions. Any significant or high profile security breach, data privacy breach or violation of data privacy laws could result in the loss of business and reputation, litigation against us, liquidated and other damages, and regulatory investigations and penalties that could adversely affect our operating results and financial condition.

The Company has a history of net losses, may incur substantial net losses in the future, and may not achieve profitability.

We have undertaken recent restructurings to reduce our expenses to be more in line with our current and projected revenue. However, if our revenues do not increase in the future, we will likely need to undertake further restructurings, operating losses will likely continue, and we may not be able to achieve profitability in the foreseeable future.

If we are unable to meet our obligations as they become due over the next twelve months, the Company may not be able to continue as a going concern.

We believe that we will be able to meet our financial obligations as they become due over the next twelve months, primarily based on our current working capital levels, our current financial projections, and our ability to secure short-term loans and raise capital when necessary.

Our ability to continue as a going concern is substantially dependent upon multiple factors, which primarily include those factors set forth above. If our financial and cash flow position the Company unfavorably compared to our internal plans and projections, we may need to consider additional actions to mitigate conditions or events that would raise substantial doubt about our ability to continue as a going concern, including the following:

- Raising additional capital through short-term loans.
- Implementing additional restructuring and cost reductions.
- Raising additional capital through a private placement or other transaction.
- Disposing of or discontinuing one or more product lines.
- Selling or licensing intellectual property.

Should our going concern assumption not be appropriate or should we become unable to continue in the normal course of operations, adjustments would be required to the amounts and classifications of assets and liabilities within our consolidated financial statements, and these adjustments could be significant. Our consolidated financial statements do not reflect the adjustments or reclassifications of assets and liabilities that would be necessary if we were to become unable to continue as a going concern.

If we fail to meet the requirements for continued listing on the NASDAQ Stock Market, our common stock would likely be delisted from trading on NASDAQ, which would likely reduce the liquidity of our common stock and could cause our trading price to decline.

Our common stock is currently listed for quotation on the NASDAQ Stock Market. We are required to meet specified financial requirements in order to maintain our listing on NASDAQ. If we fail to satisfy NASDAQ’s continued listing requirements, our common stock could be delisted from NASDAQ and our common stock would instead trade on the

OTC Market. Any potential delisting of our common stock from NASDAQ would likely result in decreased liquidity and increased volatility of our common stock, and would likely cause our trading price to decline.

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

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

The success of our products depends upon effective operation with operating systems, devices, networks and standards that we do not control and on our continued relationships with mobile operating system providers and device manufacturers.

We are dependent on the interoperability of our products with popular operating systems, networks, and standards that we do not control. For example, we depend upon the interoperability of our mobile products with the Android and iOS mobile operating systems. Any changes, bugs, or technical issues in such systems, or changes in our relationships with mobile operating system partners, handset manufacturers, or mobile carriers, or in their terms of service or policies that degrade our products' functionality, reduce or eliminate our ability to distribute our products, or give preferential treatment to competitive products could adversely affect the usage of our products.

We maintain relationships with mobile device manufacturers which provide us with insights into product development and emerging technologies. These insights allow us to keep abreast of, or to anticipate, market trends and help us to serve our current and prospective customers. Mobile device manufacturers are under no obligation to continue providing us with these valuable insights. If we are unable to maintain our existing relationships with mobile device manufacturers, if we fail to enter into relationships with additional mobile device manufacturers, or if mobile device manufacturers favor one of our competitors, our ability to provide products that meet our current and prospective customers' needs could be compromised and our reputation and future revenue prospects could suffer. For example, if our software does not function well with a popular mobile device because we have not maintained a relationship with its manufacturer, carriers seeking to provide that device to their respective customers may choose an alternative solution. Even if we succeed in establishing and maintaining these relationships, they may not result in additional customers or revenues.

Our operating income or loss may continue to change due to shifts in our sales mix and variability in our operating expenses.

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

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

Our quarterly revenues and operating results have fluctuated significantly in the past and may continue to vary from quarter to quarter due to a number of factors, many of which are not within our control. If our operating results do not meet the expectations of securities analysts or investors, our stock price may decline. Fluctuations in our operating results may be due to a number of factors, including the following:

- the gain or loss of a key customer;
- the size and timing of orders from and shipments to our major customers;
- our ability to maintain or increase gross margins;
- variations in our sales channels or the mix of our product sales;

- our ability to anticipate market needs and to identify, develop, complete, introduce, market and produce new products and technologies in a timely manner to address those needs;
- the availability and pricing of competing products and technologies and the resulting effect on sales and pricing of our products;
- acquisitions;
- the effect of new and emerging technologies;
- the timing of acceptance of new mobile services by users of our customers' services;
- deferrals of orders by our customers in anticipation of new products, applications, product enhancements or operating systems; and
- general economic and market conditions.

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

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

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

A large portion of our operating expenses, including rent, depreciation and amortization, is fixed and difficult to reduce or change. Accordingly, if our total revenue does not meet our expectations, we may not be able to adjust our expenses quickly enough to compensate for the shortfall in revenue. In that event, our business, financial condition, and results of operations would be materially and adversely affected.

Due to all of the foregoing factors, and the other risks discussed in this Report, you should not rely on quarter-to-quarter comparisons of our operating results as an indication of future performance.

We may have exposure to additional tax liabilities.

As a multinational corporation, we are subject to income taxes as well as sales, use, and other non-income based taxes, in both the U.S. and various foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes, sales and use taxes, and other tax liabilities. Changes in tax laws or tax rulings may have a significantly adverse impact on our effective tax rate.

We are also subject to non-income based taxes, such as payroll, sales, use, value-added, net worth, property, and goods and services taxes, in both the United States and various foreign jurisdictions. We are regularly under audit by tax authorities with respect to these non-income based taxes and may have exposure to additional non-income based tax liabilities. An increasing number of states have considered or have adopted laws that attempt to impose obligations on out-of-state retailers to collect sales and use taxes on their behalf. A successful assertion by one or more states or foreign countries requiring us to collect sales and use taxes where we do not do so could result in substantial tax liabilities, including for past sales, as well as penalties and interest.

Although we believe that our income and non-income based tax estimates are reasonable, there is no assurance that our provisions for taxes are correct, or that the final determination of tax audits or tax disputes will not be different from what is reflected in our historical income tax provisions and accruals. If we are required to pay substantially

more taxes in the future or for prior periods, our operating results and financial condition could be adversely affected.

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

Our software products are complex and may contain undetected defects. If we discover software defects in our products we may experience delayed or lost revenues during the period it takes to correct these problems. Defects, whether actual or perceived, could result in adverse publicity, loss of revenues, product returns, a delay in market acceptance of our products, loss of competitive position, or claims against us by customers. Any such problems could be costly to remedy and could cause interruptions, delays, or cessation of our product sales, which could cause us to lose existing or prospective customers and could negatively affect our results of operations.

Evolving information security and data privacy laws and regulations may result in increased compliance costs, impediments to the development or performance of our offerings, and monetary or other penalties.

Because our solutions process customer data that may contain personally identifying information, we are subject to federal, state and foreign laws and regulations regarding the privacy and protection of such data. These laws and regulations address a range of issues, including data privacy, cybersecurity and restrictions or technological requirements regarding the collection, use, storage, protection, retention or transfer of data. The regulatory framework for data privacy and cybersecurity issues worldwide can vary substantially from jurisdiction to jurisdiction. Foreign privacy and data protection laws and regulations can be more restrictive than those in the United States. In the European Union (“EU”), the General Data Protection Regulation (“GDPR”), came into force in May 2018. GDPR replaced the former EU Data Protection Directive and related country-specific legislation. GDPR includes operational and governance requirements for companies that collect or process personal data of residents of the European Union, and provides for significant penalties for non-compliance. The costs of compliance with, and other burdens imposed by, these laws and regulations may become substantial and may limit the use and adoption of our offerings, require us to change our business practices, impede the performance and development of our solutions, or lead to significant fines, penalties or liabilities for noncompliance with such laws or regulations.

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

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

We may be unable to adequately protect our intellectual property and other proprietary rights, and we may be subject to claims for intellectual property infringement, which could negatively impact our business and financial results.

Our success is dependent upon our software code base, our programming methodologies and other intellectual properties and proprietary rights. In order to protect our proprietary technology, we rely on a combination of trade secrets, nondisclosure agreements, patents, and copyright and trademark law. We currently own U.S. trademark registrations for certain of our trademarks and U.S. patents for certain of our technologies. However, these measures afford us only limited protection. Furthermore, we rely primarily on “shrink wrap” licenses that are not signed by the end user and, therefore, may be unenforceable under the laws of certain jurisdictions. Accordingly, it is possible that third parties may copy or otherwise obtain our rights without our authorization. It is also possible that third parties may independently develop technologies similar to ours. It may be difficult for us to detect unauthorized use of our intellectual property and proprietary rights. In addition, we sometimes include open source software in our products. As a result of our use of open source in our products, we may license or be required to license or disclose code and/or innovations that turn out to be material to our business and may also be exposed to increased litigation risk. If the protection of our proprietary rights is inadequate to prevent unauthorized use or appropriation by third parties, the

value of our brands and other intangible assets may be diminished and competitors may be able to more effectively mimic our products, services, and methods of operations. Any of these events could have an adverse effect on our business and financial results.

We may be subject to claims of intellectual property infringement as the number of trademarks, patents, copyrights, and other intellectual property rights asserted by companies in our industry grows and the coverage of these patents and other rights and the functionality of software products increasingly overlap. From time to time, we have received communications from third parties asserting that our trade name or features, content, or trademarks of certain of our products infringe upon intellectual property rights held by such third parties. We have also received correspondence from third parties separately asserting that our products may infringe on certain patents held by each of the parties. Although we are not aware that any of our products infringe on the proprietary rights of others, third parties may claim infringement by us with respect to our current or future products. Additionally, our customer agreements require that we indemnify our customers for infringement claims made by third parties involving our intellectual property embedded in their products. Infringement claims, whether with or without merit, could result in time-consuming and costly litigation, divert the attention of our management, cause product shipment delays, or require us to enter into royalty or licensing agreements with third parties. If we are required to enter into royalty or licensing agreements, they may not be on terms that are acceptable to us. Unfavorable royalty or licensing agreements could seriously impair our ability to market our products and have an adverse effect on our business and financial results.

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

In recent years, our revenues derived from sales to customers outside the U.S. have not been material. Our revenues derived from such sales can vary from quarter to quarter and from year to year. We also frequently ship products to our domestic customers' international manufacturing divisions and subcontractors. In the future, we may expand these international business activities. International operations are subject to many inherent risks, including:

- general political, social and economic instability;
- trade restrictions;
- the imposition of governmental controls;
- exposure to different legal standards, particularly with respect to intellectual property;
- burdens of complying with a variety of foreign laws, including without limitation data privacy laws, such as the GDPR in Europe;
- import and export license requirements and restrictions of the United States and any other country in which we operate;
- unexpected changes in regulatory requirements;
- foreign technical standards;
- changes in tariffs;
- difficulties in staffing and managing international operations;
- difficulties in securing and servicing international customers;
- difficulties in collecting receivables from foreign entities;
- fluctuations in currency exchange rates and any imposition of currency exchange controls; and
- potentially adverse tax consequences.

These conditions may increase our cost of doing business. Moreover, as our customers are adversely affected by these conditions, our business with them may be disrupted and our results of operations could be adversely affected.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

Item 2. PROPERTIES

Our corporate headquarters is located in Pittsburgh, Pennsylvania, where we currently lease approximately 55,600 square feet of space under a lease that expires on December 31, 2021. We sublease 19,965 square feet of our leased space in Pittsburgh under an agreement which commenced on February 1, 2015 and continues for the remainder of our lease term. We lease and occupy approximately 24,688 square feet of space in Aliso Viejo, California under a lease that expires on May 31, 2019. We lease an additional 19,100 square feet in Aliso Viejo, California under a lease that expires January 31, 2022, which we have subleased to a third party through January 31, 2022. Internationally, we lease 6,300 square feet in Belgrade, Serbia under a lease that expires December 31, 2021, we lease 6,900 square feet in Stockholm, Sweden under a lease that expires May 31, 2019, and we lease 3,200 square feet in Braga, Portugal under a lease that expires July 31, 2021.

Item 3. LEGAL PROCEEDINGS

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

Item 4. MINE SAFETY DISCLOSURES

Not Applicable.

PART II

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

Market Information

Our common stock is traded on the NASDAQ Stock 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, 2018: | | |
| First Quarter | $2.96 | $1.45 |
| Second Quarter | 2.73 | 1.56 |
| Third Quarter | 2.85 | 2.20 |
| Fourth Quarter | 2.85 | 1.62 |
| YEAR ENDED DECEMBER 31, 2017: | | |
| First Quarter | $2.32 | $0.80 |
| Second Quarter | 1.70 | 0.81 |
| Third Quarter | 1.52 | 0.88 |
| Fourth Quarter | 3.41 | 1.09 |

On March 21, 2019, the closing sale price for our common stock as reported by NASDAQ was $2.86.

For information regarding Securities Authorized for Issuance under Equity Compensation Plans, please refer to Item 12 in Part III of this Annual Report on Form 10-K.

Holders

As of March 21, 2019, there were approximately 109 holders of record of our common stock based on information provided by our transfer agent.

Dividends

We have never declared or paid any cash dividends on our common stock. We do not expect to pay any cash dividends on our common stock for the foreseeable future. Any determination to pay dividends on our common stock in the future will be at the discretion of our Board of Directors, subject to applicable laws, and will depend on our financial condition, operating results, capital requirements, general business conditions, and other factors that our Board of Directors considers relevant. Any declaration and payment of dividends on our common stock will be further subject to the preferential dividend rights of holders of shares of our Series B 10% Convertible Preferred Stock (the "Series B Preferred Stock"), to the extent any such shares remain outstanding.

The holders of our Series B Preferred Stock are entitled to receive, out of funds legally available therefor, cumulative cash dividends on such shares at a rate per share of ten percent (10%) per annum, payable (i) when and as declared by our Board of Directors, in quarterly installments on March 1, June 1, September 1 and December 1, (ii) upon conversion of such shares into common stock, and (iii) upon our optional redemption of such shares in accordance

with the terms set forth in the Certificate of Designation for our Series B Preferred Stock.

Purchases of Equity Securities by the Company

The table set forth below shows all purchases of securities by us during the fourth quarter of fiscal year 2018:

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | Total Number of Shares (or Units) Purchased | Average Price Paid per Share (or Unit) | Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| October 1 - 31, 2018 | 8,595 | $ 2.56 | — | — |
| November 1 - 30, 2018 | 8,595 | $ 2.13 | — | — |
| December 1 - 31, 2018 | 8,595 | $ 2.01 | — | — |
| Total | 25,785 (a) | | — | — |

The above table includes:

(a) Acquisition of stock by the Company as payment of withholding taxes in connection with the vesting of restricted stock awards in an aggregate amount of 25,785 shares during the periods set forth in the table. All of the shares were cancelled when they were acquired.

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes thereto appearing elsewhere in this Report. The following selected consolidated statements of operations and comprehensive loss data and the consolidated balance sheet data as of and for the years ended December 31, 2018 and 2017 have been derived from audited consolidated financial statements included elsewhere in this Report. The consolidated statements of operations and comprehensive loss data and the consolidated balance sheet data presented below as of and for the years ended December 31, 2016, 2015 and 2014 are derived from audited consolidated financial statements that are not included in this Report.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Consolidated Statement of Operations and Comprehensive Loss Data (in thousands, except per share data): | | | | | |
| Revenues | $26,285 | $22,974 | $28,235 | $39,507 | $36,979 |
| Cost of revenues | 4,333 | 5,082 | 7,564 | 8,152 | 9,317 |
| Gross profit | 21,952 | 17,892 | 20,671 | 31,355 | 27,662 |
| Operating expenses: | | | | | |
| Selling and marketing | 5,784 | 6,186 | 9,615 | 8,902 | 9,559 |
| Research and development | 8,602 | 8,952 | 15,906 | 13,863 | 14,192 |
| General and administrative | 8,607 | 8,551 | 10,341 | 11,128 | 13,218 |
| Restructuring expenses | 173 | (123) | 303 | — | 2,435 |
| Long-lived asset impairment | — | — | 411 | — | — |
| Total operating expenses | 23,166 | 23,566 | 36,576 | 33,893 | 39,404 |
| Operating loss | (1,214) | (5,674) | (15,905) | (2,538) | (11,742) |
| Non-operating income (expense): | | | | | |
| Change in fair value of warrant liability | (812) | — | — | — | — |
| Change in carrying value of contingent liability | — | — | 668 | — | — |
| Loss on debt extinguishment | (203) | (405) | — | — | — |
| Interest income (expense), net | (472) | (1,120) | (313) | 1 | (5) |
| Other income (expense), net | (26) | (8) | (22) | 3 | (3) |
| Loss before provision for income taxes | (2,727) | (7,207) | (15,572) | (2,534) | (11,750) |
| Provision for income tax expense (benefit) | 13 | (546) | (229) | 68 | 49 |
| Net loss | (2,740) | (6,661) | (15,343) | (2,602) | (11,799) |
| Other comprehensive income (loss), before tax: | | | | | |
| Unrealized holding gains (losses) on | (1) | — | 2 | (1) | — |

| | | | | | |
|---|---|---|---|---|---|
| available-for-sale securities | | | | | |
| Other comprehensive income (loss), net of tax | (1) | — | 2 | (1) | — |
| Comprehensive loss | $(2,741) | $(6,661) | $(15,341) | $(2,603) | $(11,799) |
| Net loss per share: | | | | | |
| Basic | $(0.14) | $(0.49) | $(1.28) | $(0.23) | $(1.16) |
| Diluted | $(0.14) | $(0.49) | $(1.28) | $(0.23) | $(1.16) |
| Weighted average shares: | | | | | |
| Basic | 22,322 | 13,489 | 11,951 | 11,486 | 10,162 |
| Diluted | 22,322 | 13,489 | 11,951 | 11,486 | 10,162 |

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Consolidated Balance Sheet Data (in thousands): | | | | | |
| Total assets | $25,203 | $13,877 | $14,308 | $24,473 | $27,390 |
| Total liabilities | 4,640 | 9,310 | 11,249 | 10,447 | 12,488 |
| Accumulated comprehensive deficit | (236,091) | (232,933) | (226,228) | (210,887) | (208,284) |
| Total stockholders' equity | $20,563 | $4,567 | $3,059 | $14,026 | $14,902 |

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

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Report. This Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. See “Special Note Regarding Forward-Looking Statements” and Part I, Item 1A, “Risk Factors.” Readers are also urged to carefully review and consider these and other disclosures made by us which attempt to advise interested parties of the factors which affect our business.

Introduction and Overview

Smith Micro develops software to simplify and enhance the mobile experience, providing solutions to some of the leading wireless service providers and cable MSOs around the world. From enabling the family digital lifestyle to providing powerful voice messaging capabilities, our solutions enrich today’s connected lifestyles while creating new opportunities to engage consumers via smartphones and consumer IoT devices. Our portfolio also includes a wide range of products for creating, sharing and monetizing rich content, such as visual messaging, optimizing retail content display, analytics capabilities, and 2D/3D graphics applications.

During fiscal year 2018, we experienced an increase in our Wireless revenues primarily due to higher customer demand for our CommSuite product and continued SafePath subscriber growth related to a contract signed in 2017, offset by a decrease in Graphics revenue. CommSuite has achieved five quarters of continued subscriber growth since making development updates during the fourth quarter of 2017, which among other enhancements, resulted in a larger addressable market. Graphics revenue was lower due to the non-renewal of a reseller contract from late 2017. The restructuring actions taken in 2017 resulted in a full year of benefit during 2018. Additionally, the Company continued to make cost adjustments throughout the year, all resulting in lower annual operating expenses. The Company completed three separate private placements of common stock, resulting in cash proceeds to the Company of $17.6 million, which allowed the Company to repay certain short and long-term borrowings, fund a strategic acquisition and build excess cash reserves.

Results of Operations

Revenues generated from our sales to Sprint and their respective affiliates in the Wireless business segment accounted for 81% and 61% of the Company’s total revenues for fiscal years 2018 and 2017, respectively. Revenues generated from our sales to FastSpring in the Graphics business segment accounted for 5% and 14% of the Company’s total revenues for fiscal years 2018 and 2017, respectively. These two customers accounted for 84% and 72% of accounts receivable for the years ended December 31, 2018 and 2017, respectively.

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

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Revenues | 100.0 % | 100.0 % |
| Cost of revenues | 16.5 | 22.1 |
| Gross profit | 83.5 | 77.9 |
| Operating expenses: | | |
| Selling and marketing | 22.0 | 26.9 |
| Research and development | 32.7 | 39.0 |
| General and administrative | 32.7 | 37.2 |
| Restructuring expenses | 0.7 | (0.5) |
| Total operating expenses | 88.1 | 102.6 |
| Operating loss | (4.6) | (24.7) |
| Change in fair value of warrant liability | (3.1) | — |
| Loss on debt extinguishment | (0.8) | (1.8) |
| Interest expense | (1.8) | (4.9) |
| Other expense | (0.1) | — |
| Loss before provision for income taxes | (10.4) | (31.4) |
| Provision for income tax expense (benefit) | — | (2.4) |
| Net loss | (10.4)% | (29.0)% |

Revenues and Expense Components

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

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

- Wireless, which during 2018 included our SafePath®, CommSuite®, and NetWise® family of products; and
- Graphics, which during 2018 included our consumer-based products: Poser®, Moho® (formerly Anime Studio®), PhotoDonut, Rebelle, MotionArtist®, and StuffIt®.

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

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Wireless | $24,474 | $18,342 |
| Graphics | 1,811 | 4,632 |
| Total revenues | 26,285 | 22,974 |
| Cost of revenues | 4,333 | 5,082 |
| Gross profit | $21,952 | $17,892 |

Cost of revenues. Cost of revenues consists of direct product and assembly, maintenance, data center, royalties, and technical support expenses.

Selling and marketing. Selling and marketing expenses consist primarily of personnel costs, advertising costs, sales commissions, trade show expenses, and the amortization of certain intangible assets. 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. It also includes the amortization of certain intangible assets.

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

Change in carrying value of contingent liability. The change in the carrying value of the Pennsylvania grant liability. See discussion under sub-heading, “Pennsylvania Opportunity Grant Program,” appearing in Note 12 of the Notes to Consolidated Financial Statements.

Loss on debt extinguishment. Loss resulting from the extinguishment of debt.

Interest income (expense), net. Interest expense is primarily related to interest on our debt, and the credit-adjusted risk-free interest rate used to measure our operating lease termination liabilities in restructuring.

Other income (expense), net. Other income (expense) is primarily related to fixed assets disposals.

Provision for income tax expense (benefit). The Company accounts for income taxes as required by Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic No. 740, Income Taxes. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in the Company’s financial statements or tax returns. Measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and tax bases of the Company’s assets and liabilities result in a deferred tax asset, we are required to evaluate the probability of being able to realize the future benefits indicated by such asset. The deferred tax assets are reduced by a valuation allowance if, based upon all available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. Establishing, reducing or increasing a valuation allowance in an accounting period generally results in an increase or decrease in tax expense in the statement of operations. We must make significant judgments to determine the provision for income taxes, deferred tax assets and liabilities, unrecognized tax benefits, and any valuation allowance to be recorded against deferred tax assets.

Year Ended December 31, 2018 Compared to the Year Ended December 31, 2017

Revenues. Revenues of $26.3 million in 2018 increased $3.3 million, or 14.4%, from $23.0 million in 2017. Wireless revenues of $24.5 million increased $6.1 million, or 33.4%, from $18.3 million in 2017. The increase was primarily due to higher demand in both CommSuite and SafePath subscribers. CommSuite has achieved five quarters of continued subscriber growth since making development updates during the fourth quarter of 2017, which among other enhancements, resulted in a larger addressable market. Graphics sales decreased $2.8 million, or 60.9%, from $4.6 million in 2017, primarily due to lower customer demand. Our reseller agreement with Japanese software developer Celsys, which permitted us to market, license and provide support for the English-language version of Clip Studio Paint (formerly Manga Studio), terminated in 2017. As such, Clip Studio Paint was phased out of our product portfolio in 2017.

Cost of revenues. Cost of revenues of $4.3 million in 2018 decreased $0.7 million, or 14.7%, from $5.1 million in 2017. This decrease was primarily due to lower internal and external variable costs attributable to the revenue mix.

Gross profit. Gross profit of $22.0 million or 84% of revenues in 2018 increased $4.1 million, or 22.7%, from $17.9 million, or 78% of revenues in 2017. The increase was primarily due to the lower internal and external variable costs attributable to the revenue mix.

Selling and marketing. Selling and marketing expenses of $5.8 million in 2018 decreased $0.4 million, or 6.5%, from $6.2 million in 2017. This decrease was primarily due to the full year impact of our restructuring activities in early 2017 which included a reduction in force.

Research and development. Research and development expenses of $8.6 million in 2018 decreased $0.4 million, or 3.9%, from $9.0 million in 2017. This decrease was primarily due to the full year impact of our restructuring activities in early 2017 which included a reduction in force.

General and administrative. General and administrative expenses of $8.6 million in 2018 remained flat with 2017 levels.

Restructuring expenses. Restructuring expense of $0.2 million in 2018 related to additional restructuring activities initiated during 2018. Income of $0.1 million in 2017 was a result of our restructuring activities in early 2017, which included a one-time reduction in force charges of approximately $0.8 million offset by a change in the estimated restructured lease liability based on the finalization of certain sublease contracts to third parties.

Change in fair value of warrant liability. The change in fair value of warrant liability was $0.8 million in 2018. As discussed in Note 6 of the consolidated financial statements, the existing outstanding warrants were reclassified from liabilities to equity in November 2018.

Loss on debt extinguishment. Loss on debt extinguishment of $0.2 million in 2018 related to the write-off of debt issuance costs and discount as a result of the early payoff of the Unterberg note payable. Loss on debt extinguishment of $0.4 million in 2017 was a result of the extinguishment of debt related to the exchange of a related party note for the newly issued Series B Preferred Stock in September 2017.

Interest expense, net. Interest expense was $0.5 million and $1.1 million in 2018 and 2017, respectively. The decrease was due to lower debt levels during 2018.

Provision for income tax expense. Because of our loss position, the current provision for income tax expense consists of state income tax minimums, foreign tax withholdings, and foreign income taxes. After consideration of the Company’s continuing cumulative loss position as of December 31, 2018, the Company retained a valuation allowance related to its U.S.-based deferred tax assets of $52.4 million at December 31, 2018. During fiscal year 2018, the valuation allowance on deferred tax assets decreased by $0.5 million.

Liquidity and Capital Resources

Going Concern Evaluation

In connection with preparing consolidated financial statements for the year ended December 31, 2018, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about the Company’s ability to continue as a going concern within one year from the date that the financial statements are issued.

The Company considered the historical operating loss and negative cash flow from operating activities trends, including the positive trends occurring in the recent year.

The Company evaluated its ability to meet its obligations as they become due within one year from the date that the financial statements are issued by considering the following:

- In May 2017, the Company raised $2.2 million of new capital in a private placement offering of its common stock.
- In September 2017, the Company closed on a $5.5 million preferred stock transaction which converted $2.8 million of long and short-term debt, and raised $2.7 million of new capital.
- On March 5, 2018, the Company raised $5.0 million of new capital in a private placement offering of its common stock.
- On May 3, 2018, the Company raised $7.0 million of new capital in a private placement offering of its common stock.
- On November 7, 2018, the Company raised $7.5 million of new capital in a private placement offering of its common stock. Following this transaction, $3.2 million of short and long-term debt was repaid.

In addition to the recent capital raised, management also believes that the Company will generate enough cash from operations to satisfy its obligations for the next twelve months from the issuance date.

The Company will take the following actions if it starts to trend unfavorably to its internal profitability and cash flow projections, in order to mitigate conditions or events that would raise substantial doubt about its ability to continue as a going concern:

- Raise additional capital through short-term loans.
- Implement additional restructuring and cost reductions.
- Raise additional capital through a public or private placement.
- Secure a commercial bank line of credit.
- Dispose of one or more product lines.
- Sell or license intellectual property.

At December 31, 2018, we had $12.2 million in cash and cash equivalents and $16.7 million of working capital.

Operating Activities

In 2018, net cash used in operating activities was $2.9 million primarily due to an increase in accounts receivable of $1.9 million and a decrease in accounts payable and accrued liabilities of $1.1 million.

In 2017, net cash used in operating activities was $7.4 million primarily due to our net loss adjusted for non-cash items of $4.2 million, decreases of accounts payable and accrued liabilities of $2.9 million, and an increase in accounts receivable of $0.4 million.

Investing Activities

In 2018, cash used in investing activities was $0.2 million, related to capital expenditures.

In 2017, cash used in investing activities was less than $0.1 million, related to capital expenditures.

Financing Activities

In 2018, cash provided by financing activities was $13.0 million due to net proceeds from common stock offerings of $17.6 million, offset by repayments of notes payable of $4.2 million and preferred stock dividend payments of $0.4 million.

In 2017, cash provided by financing activities was $7.5 million due to net proceeds from common and preferred stock offerings of $4.5 million and proceeds from short-term promissory notes of $3.0 million.

Contractual Obligations and Commercial Commitments

During our normal course of business, we have made certain indemnities, commitments, and guarantees under which we may be required to make payments in relation to certain transactions. These include: intellectual property indemnities to our customers and licensees in connection with the use, sale and/or license of our products; indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease; indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct; indemnities involving the accuracy of representations and warranties in certain contracts; and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Delaware. We may also issue a guarantee in the form of a standby letter of credit as security for contingent liabilities under certain customer contracts.

The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees may not provide for any limitation of the maximum

potential for future payments we could be obligated to make. We have not recorded any liability for these indemnities, commitments and guarantees in the accompanying consolidated balance sheets.

Real Property Leases

Our corporate headquarters is located in Pittsburgh, Pennsylvania, where we currently lease approximately 55,600 square feet of space under a lease that expires on December 31, 2021. We sublease 19,965 square feet of our leased space in Pittsburgh under an agreement which commenced on February 1, 2015 and continues for the remainder of our lease term. We lease and occupy approximately 24,688 square feet of space in Aliso Viejo, California under a lease that expires on May 31, 2019. Internationally, we lease approximately 6,300 square feet in Belgrade, Serbia under a lease that expires December 31, 2021, we lease approximately 6,900 square feet in Stockholm, Sweden under a lease that expires May 31, 2019, and we lease approximately 3,200 square feet in Braga, Portugal under a lease that expires July 31, 2021.

We lease an additional 19,100 square feet in Aliso Viejo, California under a lease that expires January 31, 2022. In August 2014, we signed an addendum to sublease all of this space commencing on September 15, 2014 for a three-year period, with two renewal options. In October 2017, the sublease agreement was renewed through January 2022. The remaining lease expense, net of sublease income, has been accrued for in our 2013 restructuring liability account.

Off-Balance Sheet Arrangements

As of December 31, 2018, we did not have any off-balance sheet arrangements.

Critical Accounting Policies and Estimates

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

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

Business Combinations

The Company applies the provisions of FASB ASC Topic No. 805, Business Combinations, in the accounting for its acquisitions, which requires recognition of the assets acquired and the liabilities assumed at their acquisition date fair values, separately from goodwill. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the tangible and identifiable intangible assets acquired and liabilities assumed. While the Company uses its best estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date as well as contingent consideration, where applicable, its estimates are inherently uncertain and subject to refinement. As a result, during the measurement period that exists up to twelve months from the acquisition date, the Company may record adjustments to the tangible and specifically identifiable intangible assets acquired and liabilities assumed with a corresponding adjustment to goodwill in the reporting period in which the adjusted amounts are determined. Upon the conclusion of the measurement period or

final determination of the values of assets acquired and liabilities assumed, whichever comes first, the impact of any subsequent adjustments is included in the consolidated statements of operations.

Costs to exit or restructure certain activities of an acquired company or the Company's internal operations are accounted for as a one-time termination and exit cost pursuant to FASB ASC Topic No. 420, Exit or Disposal Cost Obligations, and are accounted for separately from the business combination. A liability for costs associated with an

exit or disposal activity is recognized and measured at its fair value in the Company's consolidated statement of operations in the period in which the liability is incurred.

Uncertain income tax positions and tax-related valuation allowances that are acquired in connection with a business combination are initially estimated as of the acquisition date. The Company reevaluates these items quarterly based upon facts and circumstances that existed as of the acquisition date, with any adjustments to the preliminary estimates being recorded to goodwill if such adjustments occur within the 12-month measurement period. Subsequent to the end of the measurement period or the Company's final determination of the value of the tax allowance or contingency, whichever comes first, changes to these uncertain tax positions and tax-related valuation allowances will affect the provision for income taxes in the consolidated statement of operations, and could have a material impact on results of operations and financial position.

Fair Value of Financial Instruments

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

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

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

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

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

As required by FASB ASC Topic No. 820, we measure our warrant liability at fair value. Our warrant liability is classified within Level 3 as some of the inputs to our valuation model are either not observable quoted prices or are not derived principally from, or corroborated by, observable market data by correlation or other means.

As required by FASB ASC Topic No. 825, Financial Instruments, an entity can choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. Subsequent changes in fair value for designated items are required to be reported in earnings in the current period. This Topic also establishes presentation and disclosure requirements for similar types of assets and liabilities measured at fair value.

As required by FASB ASC Topic No. 350, for goodwill and other intangibles impairment analysis, we utilize fair value measurements which are categorized within Level 3 of the fair value hierarchy.

Impairment or Disposal of Long Lived Assets

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

Equipment.

Goodwill

In accordance with FASB ASC Topic No. 350, Intangibles-Goodwill and Other, we review the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. The Company's annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the fair value of the Company's reporting units to the carrying value of the underlying net assets in the reporting units. If the fair value of a reporting unit is determined to be less than the carrying value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the fair value of the reporting unit and the fair value of its other assets and liabilities.

Intangible Assets and Amortization

Amortization expense related to other intangibles acquired in acquisitions is calculated on a straight line basis over two to six years. Intangible assets are tested for impairment if events or circumstances occur indicating that the respective asset might be impaired.

Going Concern Evaluation

In connection with preparing its consolidated financial statements, management evaluates whether there are conditions and events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year from the date that the financial statements are issued. See management's going concern evaluation for the year ended December 31, 2018 in the "Liquidity and Capital Resources" section above.

Revenue Recognition

The Company adopted FASB ASC Topic No. 606, Revenue from Contracts with Customers, as of January 1, 2018, and recognizes the sale of goods and services based on the five step analysis of transactions as provided in Topic 606 which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for such goods and services.

In our Wireless segment, we transfer software licenses to our customers on a royalty free, non-exclusive, non-transferrable, limited use basis during the term of the agreement. In some instances, we perform customization services to ensure the software operates within our customer's operating platforms as well as the operating platforms of the mobile devices used by their end customers before transferring the license. Revenue related to these services is recognized at a point in time upon acceptance of the software license by the customer. We also earn usage based revenue on our platforms. Usage based revenue is generated based on active licenses used by our customer's end customers, the provision of hosting services, revenue share based on media placements on our platform, and use of our Cloud Based services. We recognize our usage based revenue when we have completed our performance obligation and have the right to invoice the customer. This revenue is generally recognized monthly or quarterly.

We also provide consulting services to develop customer specified functionality that are generally not on our software development roadmap. We recognize revenue from our consulting services upon delivery and acceptance by the customer of our software enhancements and upgrades. For certain Wireless segment customers we provide maintenance and technology support services for which the customer pays upfront or as we provide the services. When the customer pays upfront, we record the payments as contract liabilities and recognize revenue ratably over the contract period as this is our stand ready performance obligation that is satisfied ratably over the maintenance and technology services period.

In our Graphics segment where we sell off-the-self software products with no customization or post sale technology support services, we recognize revenue at the time we transfer control of the product to the customer. This occurs

upon shipment of the product or when the customer downloads the software from our website or website of our resellers. We offer a 30 day return option to our customers; a return reserve is established at the time revenue is recorded and the reserve is monitored and adjusted based on actual experience. Historically, returns have been insignificant.

Stock-Based Compensation

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

Recently Adopted Accounting Pronouncements

In January 2017, the FASB issued Accounting Standards Update ("ASU") 2017-04, Intangibles-Goodwill and Other (Topic 350) Simplifying the Test for Goodwill Impairment, which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, under the ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The ASU is effective prospectively for fiscal years beginning after December 31, 2019, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company elected to early adopt ASU 2017-04 during 2017 for its annual goodwill impairment test. There was no impact of adoption of ASU 2017-04 on the Company's consolidated financial statements.

In July 2017, the FASB issued ASU No. 2017-11, Earnings Per Share (Topic 260) Distinguishing Liabilities from Equity (Topic 480) Derivatives and Hedging (Topic 815), which changes the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. ASU 2017-11 is effective for annual and interim periods beginning after December 15, 2018, and early adoption is permitted, including adoption in an interim period. The Company elected to early adopt ASU 2017-11 during 2017 by applying ASU 2017-11 retrospectively to outstanding financial instruments with a round down feature for each prior reporting period presented, as well as a cumulative-effect adjustment to the Company's beginning accumulated deficit as of January 1, 2017.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 clarifies the principles for recognizing revenue when an entity either enters into a contract with customers to transfer goods or services or enters into a contract for the transfer of non-financial assets. The Company adopted ASU 2014-09 as of January 1, 2018 utilizing the modified retrospective approach. This adoption did not have a material impact on our consolidated financial statements. See Note 11 for further details.

Recently Issued Accounting Standards Not Yet Adopted

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

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820), which is designed to improve the effectiveness of disclosures related to fair value measurements. This ASU is effective for annual periods beginning after December 15, 2019 and early adoption is allowed in any interim reporting periods within those annual

reporting periods. The Company is currently assessing the impact that this ASU will have on its consolidated financial statements.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements appear in a separate section of this Annual Report on Form 10-K beginning on page F-1.

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

None.

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 ("Exchange Act")) as of December 31, 2018. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer determined that as of December 31, 2018, 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 SEC'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 consolidated financial statements fairly represent the Company's financial position and results of operations for the periods and as of the dates stated therein.

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

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal controls over financial reporting during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Report of Management on Internal Control Over Financial Reporting

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

Our management, including the Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2018. Management based this assessment on criteria for effective internal control over financial reporting described in “Internal Control-Integrated Framework 2013” issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, management determined that, as of December 31, 2018, we maintained effective internal control over financial reporting.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is set forth under the headings “Proposal 1: Election of Directors,” “Executive Officers,” “Corporate Governance,” and “Section 16(a) Beneficial Ownership Compliance” in the Company’s definitive Proxy Statement for the 2019 Annual Meeting of Stockholders (“2019 Proxy Statement”) and is incorporated herein by reference.

Item 11. EXECUTIVE COMPENSATION

The information required by this Item is set forth under the headings “Executive Compensation” and “Compensation of Directors” in the Company’s 2019 Proxy Statement and is incorporated herein by reference.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

A portion of the information required by this Item is set forth under the heading “Security Ownership of Certain Beneficial Owners and Management” in the Company’s 2019 Proxy Statement and is incorporated herein by reference.

Securities Authorized for Issuance Under an Equity Compensation Plan

The following table summarizes information as of December 31, 2018 for the equity compensation plans of the Company pursuant to which grants of options, restricted stock, restricted stock units or other rights to acquire shares may be granted from time to time (in thousands, except option price data):

| | Number of shares to be issued upon exercise of outstanding options | Weighted average exercise price of outstanding options | Number of shares remaining available for future issuance |
|---|---|---|---|
| 2015 Omnibus Equity Incentive Plan (1) | 47 | $ 2.40 | 2,801 |
| 2005 Stock Option / Stock Issuance Plan (2) | 113 | 5.91 | — |
| Total | 160 | $ 4.88 | 2,801 |

(1) The 2015 Omnibus Equity Incentive Plan (the “2015 OEIP”) was approved by shareholders effective June 18, 2015.
(2) Upon shareholder approval of the 2015 OEIP, any unissued shares under the 2005 Plan were canceled and no longer available for future issuance.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item is set forth under the heading “Proposal 1: Election of Directors” and under the subheadings “Board Member Independence,” “Audit Committee,” “Compensation Committee,” “Governance and Nominating Committee,” and “Certain Relationships and Related Party Transactions” under the heading “Corporate Governance” in the Company’s 2019 Proxy Statement and is incorporated herein by reference.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is set forth under the heading “Proposal 3: Ratification of Appointment of Independent Registered Public Accounting Firm” in the Company’s 2019 Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. EXHIBITS

(a) (1) Financial Statements

Smith Micro's financial statements appear in a separate section of this Annual Report on Form 10-K beginning on the pages referenced below:


| | Page |
|---|---|
| REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM | F-1 |
| CONSOLIDATED BALANCE SHEETS | F-2 |
| CONSOLIDATED STATEMENTS OF OPERATIONS | F-3 |
| CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY | F-4 |
| CONSOLIDATED STATEMENTS OF CASH FLOWS | F-5 |
| NOTES TO CONSOLIDATED FINANCIAL STATEMENTS | F-6 |


(3) Exhibits

| Exhibit No. | Title | Method of Filing |
|---|---|---|
| 2.1 | Asset Purchase Agreement, dated as of December 17, 2018, between the Company and ISM Connect, LLC | Incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on December 18, 2018 |
| 3.1 | Amended and Restated Certificate of Incorporation | Incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement No. 33-95096 (P) |
| 3.1.1 | Certificate of Amendment to Amended and Restated Certificate of Incorporation dated July 11, 2000 | Incorporated by reference to Exhibit 3.1.1 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2000, filed on August 14, 2000 |
| 3.1.2 | Certificate of Amendment of Amended and Restated Certificate of Incorporation dated August 17, 2005 | Incorporated by reference to Exhibit 3.1.2 to the Registrant's Annual Report on Form 10-K for the period ended December 31, 2005, filed on March 31, 2006 |
| 3.1.3 | | |

| | | |
|---|---|---|
| | Certificate of Amendment to Amended and Restated Certificate of Incorporation dated June 21, 2012 | Incorporated by reference to Appendix B to the Registrant's Definitive Proxy Statement on Schedule 14A filed on April 27, 2012 |
| 3.1.4 | Certificate of Elimination of Series A Junior Participating Preferred Stock dated October 16, 2015 | Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on October 16, 2015 |
| 3.1.5 | Certificate of Designation of Series A Participating Preferred Stock dated October 16, 2015 | Incorporated by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed on October 16, 2015 |
| 3.1.6 | Certificate of Amendment to Amended and Restated Certificate of Incorporation dated August 15, 2016 | Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on August 17, 2016 |

| Exhibit No. | Title | Method of Filing |
|---|---|---|
| 3.1.7 | Certificate of Designation of Preferences, Rights and Limitations of Series B 10% Convertible Preferred Stock, dated September 29, 2017 | Incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on October 4, 2017 |
| 3.2 | Amended and Restated Bylaws | Incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement No. 33-95096 (P) |
| 3.2.1 | Certificate of Amendment of Amended and Restated Bylaws | Incorporated by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8-K filed on October 31, 2007 |
| 4.1 | Specimen certificate representing shares of Common Stock | Incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement No. 33-95096 (P) |
| 4.2 | Preferred Shares Rights Agreement, dated as of October 16, 2015, between the Registrant and Computershare Trust Company, N.A., as Rights Agent | Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on October 16, 2015 |
| 4.3 | Form of Common Stock Purchase Warrant, dated May 17, 2017, issued by the Registrant to each of Sutter Securities Incorporated and Chardan Capital Markets, LLC | Incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on May 17, 2017 |
| 4.4 | Form of Registration Rights Agreement dated August 15, 2014 | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on August 20, 2014 |
| 4.5 | Form of Warrant to Purchase Common Stock, dated September 6, 2016, issued by the Registrant to each of the Investors party to the Note and Warrant Purchase Agreement dated September 2, 2016 | Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on September 7, 2016 |
| 4.6 | Form of Registration Rights Agreement, dated September 6, 2016 entered into between the Registrant and each of the Investors party thereto | Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on September 7, 2016 |
| 4.7 | Registration Rights Agreement, dated as of September 29, 2017, between the Registrant and each of the Purchasers party thereto | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on October 4, 2017 |
| 4.8 | Registration Rights Agreement, dated as of March 5, 2018, between the Registrant and each of the Purchasers party thereto | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on March 6, 2018 |
| 4.9 | Form of Warrant to Purchase Common Stock, issued by the Registrant to each of the Purchasers party to the March SPA (defined below) | Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on March 6, 2018 |

| | | |
|---|---|---|
| 4.10 | Registration Rights Agreement, dated as of May 3, 2018, between the Registrant and each of the Purchasers party thereto | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on May 4, 2018 |
| 4.11 | Form of Warrant to Purchase Common Stock, issued by the Registrant to each of the Purchasers party to the May SPA (defined below) | Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on May 4, 2018 |

| Exhibit No. | Title | Method of Filing |
|---|---|---|
| 4.12 | Registration Rights Agreement, dated as of November 7, 2018, between the Registrant and each of the Purchasers party thereto | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on November 7, 2018 |
| 4.13 | Form of Warrant to Purchase Common Stock, issued by the Registrant to each of the Purchasers party to the November SPA (defined below) | Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on November 7, 2018 |
| 10.1 | Form of Indemnification Agreement | Incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement No. 33-95096 (P) |
| 10.2* | Amended and Restated 2005 Stock Option / Stock Issuance Plan | Incorporated by reference to Exhibit 10.7 to the Registrant's Registration Statement on Form S-8 (Reg. No. 333-149222) filed on February 13, 2008 |
| 10.3 | Summary of oral agreement dated June 2005 by and between William W. Smith, Jr. and the Registrant | Incorporated by reference to Exhibit 10.10 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 |
| 10.4* | Amended & Restated Employee Stock Purchase Plan | Incorporated by reference to Exhibit 10.11 to the Registrant's Registration Statement on Form S-8 (No. 333-169671) filed on September 30, 2010 |
| 10.5 | Form of Common Stock Purchase Agreement dated August 15, 2014 | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 20, 2014 |
| 10.6* | 2015 Omnibus Equity Incentive Plan | Incorporated by reference to Appendix A to the Registrant's Definitive Proxy Statement on Schedule 14A filed on April 30, 2015 |
| 10.6.1* | Form of Restricted Stock Agreement under the 2015 Omnibus Equity Incentive Plan | Incorporated by reference to Exhibit 10.6.1 to the Registrant's Annual Report on Form 10-K filed on March 30, 2018 |
| 10.6.2* | Amendment to Smith Micro Software, Inc. 2015 Omnibus Equity Incentive Plan, adopted June 14, 2018 | Incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed on June 15, 2018 |
| 10.7 | Note and Warrant Purchase Agreement, dated September 2, 2016, by and among the Company and each of the Investors party thereto | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on September 7, 2016 |
| 10.8 | Form of Senior Subordinated Promissory Note, dated September 6, 2016, issued by the Registrant to each of the | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K |

| | | |
|---|---|---|
| | Investors party to the Note and Warrant Purchase Agreement dated September 2, 2016 | filed on September 7, 2016 |
| 10.9 | Amendment to Senior Subordinated Promissory Note, dated December 27, 2016, between the Registrant and Unterberg Koller Capital Fund L.P. | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on December 28, 2016 |
| 10.10 | Form of Subscription Agreement, dated May 16, 2017, between the Registrant and each of the investors party thereto | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on May 17, 2017 |

| Exhibit No. | Title | Method of Filing |
|---|---|---|
| 10.11* | Offer Letter by and between the Registrant and Timothy C. Huffmyer, dated June 19, 2017 | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on June 20, 2017 |
| 10.12 | Secured Promissory Note dated June 26, 2017, issued by the Registrant to William W. Smith, Jr. and Dieva L. Smith | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on July 7, 2017 |
| 10.12.1 | Amendment to Secured Promissory Note, dated January 30, 2018, between the Registrant and William W. Smith, Jr. and Dieva L. Smith | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on January 31, 2018 |
| 10.12.2 | Second Amendment to Secured Promissory Note, dated March 5, 2018, between the Registrant and William W. Smith, Jr. and Dieva L. Smith | Incorporated by reference to Exhibit 10.20.2 to the Registrant's Annual Report on Form 10-K filed on March 30, 2018 |
| 10.13 | Secured Promissory Note dated June 23, 2017, issued by the Registrant to Steven L. and Monique P. Elfman | Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on July 7, 2017 |
| 10.13.1 | Amendment to Secured Promissory Note, dated August 18, 2017, between the Registrant and Steven L. and Monique P. Elfman | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on August 25, 2017 |
| 10.13.2 | Second Amendment to Secured Promissory Note, dated January 30, 2018, between the Registrant and Steven L. and Monique P. Elfman | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 31, 2018 |
| 10.14* | Resignation Severance and Release Agreement, dated as of July 10, 2017, between the Registrant and Steven Yasbek | Incorporated by reference to Exhibit 99.1 to the Registrant's Current Report on Form 8-K/A filed on July 11, 2017 |
| 10.15 | Secured Promissory Note, dated August 24, 2017, issued by the Registrant to Next Generation TC FBO Andrew Arno IRA 1663 | Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on August 25, 2017 |
| 10.15.1 | Amendment to Secured Promissory Note, dated January 30, 2018, between the Registrant and Next Generation TC FBO Andrew Arno IRA 1663 | Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on January 31, 2018 |
| 10.15.2 | Second Amendment to Secured Promissory Note, dated March 5, 2018, between the Registrant and Next Generation TC FBO Andrew Arno IRA 1663 | Incorporated by reference to Exhibit 10.24.2 to the Registrant's Annual Report on Form 10-K filed on March 30, 2018 |
| 10.16 | Secured Promissory Note, dated August 24, 2017, issued by the Registrant to Andrew Arno | Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on August 25, 2017 |

| | | |
|---|---|---|
| 10.16.1 | Amendment to Secured Promissory Note, dated January 30, 2018, between the Registrant and Andrew Arno | Incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed on January 31, 2018 |
| 10.16.2 | Second Amendment to Secured Promissory Note, dated March 5, 2018, between the Registrant and Andrew Arno | Incorporated by reference to Exhibit 10.25.2 to the Registrant's Annual Report on Form 10-K filed on March 30, 2018 |

| Exhibit No. | Title | Method of Filing |
|---|---|---|
| 10.17 | Securities Purchase Agreement, dated as of September 29, 2017, between the Registrant and each of the Purchasers party thereto | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 4, 2017 |
| 10.18 | Securities Purchase Agreement, dated as of March 5, 2018, between the Registrant and each of the Purchasers party thereto (the "March SPA") | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on March 6, 2018 |
| 10.19 | Letter Agreement, dated March 5, 2018, between the Company and William W. Smith, Jr. and Dieva L. Smith | Incorporated by reference to Exhibit 10.11 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 |
| 10.20 | Letter Agreement, dated March 5, 2018, between the Company and Andrew Arno | Incorporated by reference to Exhibit 10.12 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 |
| 10.21 | Form of Lock-Up Agreement entered into between the Company and each of its directors and certain executive officers in connection with the March SPA | Incorporated by reference to Exhibit 10.13 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 |
| 10.22 | Form of Voting Agreement entered into between the Company and each of its directors and certain executive officers in connection with the March SPA | Incorporated by reference to Exhibit 10.14 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 |
| 10.23 | Securities Purchase Agreement, dated as of May 3, 2018, between the Registrant and each of the Purchasers party thereto (the "May SPA") | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on May 4, 2018 |
| 10.24 | Securities Purchase Agreement, dated as of November 7, 2018, between the Registrant and each of the Purchasers party thereto (the "November SPA") | Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on November 7, 2018 |
| 21.1 | Subsidiaries | Filed herewith |
| 23.1 | Consent of Independent Registered Public Accounting Firm | Filed herewith |
| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Filed herewith |
| 31.2 | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Filed herewith |
| 32.1 | Certifications of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Furnished herewith |

| | | |
|---|---|---|
| 101.INS | XBRL Instance Document | Filed herewith |
| 101.SCH | XBRL Taxonomy Extension Schema Document | Filed herewith |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | Filed herewith |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | Filed herewith |

| | | |
|---|---|---|
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | Filed herewith |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | Filed herewith |

(P) Paper Filing Exhibit

*denotes the management contracts and compensatory arrangements in which any director or named executive officer participates

(b) Exhibits
The exhibits filed as part of this report are listed above in Item 15(a) (3) of this Form 10-K.

Item 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

SMITH MICRO SOFTWARE, INC.

Date: March 27, 2019 By: /s/ William W. Smith, Jr.
William W. Smith, Jr.
Chairman of the Board,
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 27, 2019 By: /s/ Timothy C. Huffmyer
Timothy C. Huffmyer
Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ William W. Smith, Jr.<br>William W. Smith, Jr. | Chairman of the Board,<br>President and Chief Executive Officer<br>(Principal Executive Officer) | March 27, 2019 |
| /s/ Timothy C. Huffmyer<br>Timothy C. Huffmyer | Vice President and Chief Financial Officer<br>(Principal Financial and Accounting Officer) | March 27, 2019 |
| /s/ Andrew Arno<br>Andrew Arno | Director | March 27, 2019 |
| /s/ Thomas G. Campbell<br>Thomas G. Campbell | Director | March 27, 2019 |
| /s/ Steven L. Elfman<br>Steven L. Elfman | Director | March 27, 2019 |
| /s/ Samuel Gulko<br>Samuel Gulko | Director | March 27, 2019 |
| /s/ Gregory J. Szabo | Director | March 27, 2019 |

Gregory J. Szabo

42

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors

Smith Micro Software, Inc. and its subsidiaries

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Smith Micro Software, Inc. and its subsidiaries (collectively, the “Company”) as of December 31, 2018 and 2017, the related statements of operations and comprehensive loss, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ SingerLewak LLP

We have served as the Company's auditor since 2004.

Los Angeles, California

March 27, 2019

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and par value data)

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $12,159 | $2,205 |
| Accounts receivable, net of allowances for doubtful accounts and other adjustments of $135 and $221 at December 31, 2018 and 2017, respectively | 7,130 | 5,145 |
| Prepaid expenses and other current assets | 795 | 576 |
| Total current assets | 20,084 | 7,926 |
| Equipment and improvements, net | 865 | 1,229 |
| Deferred tax asset, net | 191 | 404 |
| Other assets | 140 | 146 |
| Intangible assets, net | 238 | 487 |
| Goodwill | 3,685 | 3,685 |
| Total assets | $25,203 | $13,877 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | $1,160 | $1,333 |
| Accrued payroll and benefits | 1,745 | 1,994 |
| Related party notes payable | — | 1,000 |
| Other accrued liabilities | 450 | 416 |
| Deferred revenue | 28 | 73 |
| Total current liabilities | 3,383 | 4,816 |
| Non-current liabilities: | | |
| Related-party notes payable, net of discount & issuance costs of $0 at December 31, 2017 | — | 1,200 |
| Notes payable, net of discount & issuance costs of $442 at December 31, 2017 | — | 1,558 |
| Deferred rent | 723 | 970 |
| Other long term liabilities | 534 | 766 |
| Total non-current liabilities | 1,257 | 4,494 |
| Commitments and contingencies (Note 12) | | |
| Stockholders' equity: | | |
| Preferred stock, par value $0.001 per share; 5,000,000 shares authorized; 1,345 and 5,500 shares issued and outstanding at December 31, 2018 and 2017, respectively | — | — |

| | | |
|---|---|---|
| Common stock, par value $0.001 per share; 100,000,000 shares authorized; 28,241,129 and 14,268,765 shares issued and outstanding at December 31, 2018 and 2017, respectively | 28 | 14 |
| Additional paid-in capital | 256,626 | 237,486 |
| Accumulated comprehensive deficit | (236,091) | (232,933) |
| Total stockholders' equity | 20,563 | 4,567 |
| Total liabilities and stockholders' equity | $25,203 | $13,877 |

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amount)

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Revenues | $26,285 | $22,974 |
| Cost of revenues | 4,333 | 5,082 |
| Gross profit | 21,952 | 17,892 |
| Operating expenses: | | |
| Selling and marketing | 5,784 | 6,186 |
| Research and development | 8,602 | 8,952 |
| General and administrative | 8,607 | 8,551 |
| Restructuring expenses | 173 | (123) |
| Total operating expenses | 23,166 | 23,566 |
| Operating loss | (1,214) | (5,674) |
| Non-operating expense: | | |
| Change in fair value of warrant liability | (812) | — |
| Loss on debt extinguishment | (203) | (405) |
| Interest expense, net | (472) | (1,120) |
| Other expense, net | (26) | (8) |
| Loss before provision for income taxes | (2,727) | (7,207) |
| Provision for income tax expense (benefit) | 13 | (546) |
| Net loss | (2,740) | (6,661) |
| Other comprehensive loss, before tax: | | |
| Unrealized holding losses on available-for-sale securities | (1) | — |
| Other comprehensive loss, net of tax | (1) | — |
| Comprehensive loss | $(2,741) | $(6,661) |
| | | |
| Net loss per share: | | |
| Basic and diluted | $(0.14) | $(0.49) |
| Weighted average shares outstanding: | | |
| Basic and diluted | 22,322 | 13,489 |

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

| | Preferred stock Shares | Amount | Common stock Shares | Amount | Additional paid-in capital | Accumulated comprehensive deficit | Total |
|---|---|---|---|---|---|---|---|
| BALANCE, December 31, 2016 | — | $ — | 12,298 | $ 12 | $ 229,275 | $ (226,228) | $ 3,059 |
| Non-cash compensation recognized on stock options and ESPP | — | — | — | — | 44 | — | 44 |
| Restricted stock grants, net of cancellations | — | — | (69) | — | 1,127 | — | 1,127 |
| Cancellation of shares for payment of withholding tax | — | — | (126) | — | (171) | — | (171) |
| Employee stock purchase plan | — | — | 4 | — | 3 | — | 3 |
| Preferred shares issued in stock offering, net of offering costs | 3 | — | — | — | 5,213 | — | 5,213 |
| Common shares issued in stock offering, net of offering costs | — | — | 2,162 | 2 | 1,990 | — | 1,992 |
| Issuance of warrants in stock offering | — | — | — | — | 64 | — | 64 |
| Preferred shares issued with debt conversion | 3 | — | — | — | (103) | — | (103) |
| Warrant repricing | — | — | — | — | 44 | (44) | — |
| Net loss | — | — | — | — | — | (6,661) | (6,661) |
| BALANCE, December 31, 2017 | 6 | $ — | 14,269 | $ 14 | $ 237,486 | $ (232,933) | $ 4,567 |
| Non-cash compensation recognized on stock options and ESPP | — | — | — | — | 36 | — | 36 |
| Restricted stock grants, net of cancellations | — | — | 1,124 | 1 | 898 | — | 899 |
| Cancellation of shares for payment of withholding tax | — | — | (94) | — | (209) | — | (209) |
| Employee stock purchase plan | — | — | 5 | — | 5 | — | 5 |
| Preferred shares converted to common shares | (5) | — | 3,645 | 4 | (4) | — | — |
| Common shares issued in stock offering, net of offering costs | — | — | 9,267 | 9 | 17,591 | — | 17,600 |
| Issuance of warrants in stock offering | — | — | — | — | (6,792) | — | (6,792) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Exercise of warrants | — | — | 26 | — | — | — | — |
| Reclassification of warrants previously classified as liabilities to equity | — | — | — | — | 7,604 | — | 7,604 |
| Warrant repricing | — | — | — | — | 11 | (11) | — |
| Canadian tax adjustments from prior period | — | — | — | — | — | (2) | (2) |
| Preferred stock dividends | — | — | — | — | — | (404) | (404) |
| Comprehensive loss | — | — | — | — | — | (2,741) | (2,741) |
| BALANCE, December 31, 2018 | 1 | $ — | 28,242 | $ 28 | $ 256,626 | $ (236,091) | $ 20,563 |

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Operating activities: | | |
| Net loss | $(2,740) | $(6,661) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 779 | 922 |
| Amortization of debt discounts and financing issuance costs | 239 | 459 |
| Restructuring reserve adjustment | — | (123) |
| Change in fair value of warrant liability | 812 | — |
| Loss on debt extinguishment | 203 | 405 |
| Provision for adjustments to accounts receivable and doubtful accounts | (82) | 182 |
| Provision for excess and obsolete inventory | (16) | — |
| Loss (gain) on disposal of fixed assets | 7 | (6) |
| Non-cash compensation related to stock options and restricted stock | 935 | 1,171 |
| Deferred income taxes | 213 | (585) |
| Change in operating accounts: | | |
| Accounts receivable | (1,903) | (365) |
| Prepaid expenses and other assets | (197) | 154 |
| Accounts payable and accrued liabilities | (1,079) | (2,947) |
| Deferred revenue | (45) | (25) |
| Net cash used in operating activities | (2,874) | (7,419) |
| Investing activities: | | |
| Capital expenditures | (173) | (77) |
| Net cash used in investing activities | (173) | (77) |
| Financing activities: | | |
| Cash received from issuance of common stock and warrants, net of offering costs | 17,600 | 2,056 |
| Cash received from issuance of preferred stock, net of offering costs | — | 2,413 |
| Cash received from (repayments of) short-term secured promissory notes | (1,000) | 1,800 |
| Cash received from (repayments of) related-party notes payable | (1,200) | 1,200 |
| Repayments of notes payable | (2,000) | — |
| Cash received from stock sale for employee stock purchase plan | 5 | 3 |
| Preferred stock dividends | (404) | — |
| Net cash provided by financing activities | 13,001 | 7,472 |
| Net increase (decrease) in cash and cash equivalents | 9,954 | (24) |
| Cash and cash equivalents, beginning of period | 2,205 | 2,229 |
| Cash and cash equivalents, end of period | $12,159 | $2,205 |
| | | |
| Supplemental disclosures of cash flow information: | | |
| Cash paid for income taxes | $2 | $15 |
| Cash paid for interest expense | $386 | $662 |

| | | |
|---|---|---|
| Non-cash investing and financing activities: | | |
| Change in unrealized loss on short-term investments | $(1) | $— |
| Issuance of common stock warrants in connection with stock offering | $10,792 | $64 |
| Reclassification of warrants from liabilities to equity | $7,604 | $— |
| Conversion of preferred stock to common stock | $4 | $— |
| Issuance of preferred stock in settlement of senior subordinated debt | $— | $2,800 |

See accompanying notes to the consolidated financial statements.

SMITH MICRO SOFTWARE, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The Company

Smith Micro develops software to simplify and enhance the mobile experience, providing solutions to some of the leading wireless service providers and cable MSOs around the world. From enabling the family digital lifestyle to providing powerful voice messaging capabilities, our solutions enrich today's connected lifestyles while creating new opportunities to engage consumers via smartphones and consumer IoT devices. Our portfolio also includes a wide range of products for creating, sharing and monetizing rich content, such as visual messaging, optimizing retail content display, analytics capabilities, and 2D/3D graphics applications.

In general, we offer our customers:

- Valuable digital services for the connected digital lifestyle, including family location and parental controls, as well as enabling connected family and consumer IoT devices to mobile consumers worldwide;
- Easy visual access to wirelessly delivered voicemail messages, while also providing easy conversion of voice messages to text and email messages;
- Efficient, consistent and measurable retail content that educates consumers, creates awareness of products and services and drives in store sales;
- Optimized wireless networks, reduced operational costs, and "best-connected" user experiences; and
- The ability to design and create 2D and 3D digital illustrations, animation and figure design with easy-to-use, professional-grade graphics software.

We continue to innovate and evolve our business to take advantage of industry trends and opportunities in emerging markets, such as digital lifestyle services and online safety, "Big Data" analytics, automotive telematics, and the consumer IoT marketplace. The key to our longevity, however, is not simply technological innovation, but a never-ending focus on customer value.

Basis of Presentation

The accompanying consolidated financial statements reflect the operating results and financial position of Smith Micro and its wholly owned subsidiaries in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). All intercompany amounts have been eliminated in consolidation.

Foreign Currency Transactions

The Company has international operations resulting from current and prior year acquisitions. The countries in which the Company has a subsidiary or branch office in are Serbia, Sweden, Portugal, the United Kingdom and Canada. The functional currency for all of these foreign entities is the U.S. dollar in accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic No. 830-30, Foreign Currency Matters-Translation of Financial Statements. Foreign currency transactions that increase or decrease expected functional currency cash flows is a foreign currency transaction gain or loss that are included in determining net income for the period in which the exchange rate changes. Likewise, a transaction gain or loss (measured from the transaction date or the most recent intervening balance sheet date, whichever is later) realized upon settlement of a foreign currency transaction is included in determining net income for the period in which the transaction is settled.

Business Combinations

The Company applies the provisions of FASB ASC Topic No. 805, Business Combinations, in the accounting for its acquisitions, which requires recognition of the assets acquired and the liabilities assumed at their acquisition date fair values, separately from goodwill. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the tangible and identifiable intangible assets acquired and liabilities assumed. While the Company uses its best estimates and assumptions to accurately value assets acquired and liabilities assumed at the acquisition date as well as contingent consideration, where applicable, its estimates are inherently uncertain and subject to refinement. As a result, during the measurement period that exists up to twelve months from the acquisition date, the Company may record adjustments to the tangible and specifically identifiable intangible assets acquired and liabilities assumed with a corresponding adjustment to goodwill in the reporting period in which the adjusted amounts are determined. Upon the conclusion of the measurement period or final determination of the values of assets acquired and liabilities assumed, whichever comes first, the impact of any subsequent adjustments is included in the consolidated statements of operations.

Costs to exit or restructure certain activities of an acquired company or the Company’s internal operations are accounted for as a one-time termination and exit cost pursuant to FASB ASC Topic No. 420, Exit or Disposal Cost Obligations, and are accounted for separately from the business combination. A liability for costs associated with an exit or disposal activity is recognized and measured at its fair value in the Company’s consolidated statement of operations in the period in which the liability is incurred.

Uncertain income tax positions and tax-related valuation allowances that are acquired in connection with a business combination are initially estimated as of the acquisition date. The Company reevaluates these items quarterly based upon facts and circumstances that existed as of the acquisition date, with any adjustments to the preliminary estimates being recorded to goodwill if such adjustments occur within the 12-month measurement period. Subsequent to the end of the measurement period or the Company’s final determination of the value of the tax allowance or contingency, whichever comes first, changes to these uncertain tax positions and tax-related valuation allowances will affect the provision for income taxes in the consolidated statement of operations, and could have a material impact on results of operations and financial position.

Use of Estimates

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

Fair Value of Financial Instruments

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

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

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

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

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

As required by FASB ASC Topic No. 820, we measured our warrant liability at fair value. Our warrant liability was classified within Level 3 as some of the inputs to our valuation model are either not observable quoted prices or are not derived principally from, or corroborated by, observable market data by correlation or other means.

As required by FASB ASC Topic No. 825, Financial Instruments, an entity can choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. Subsequent changes in fair value for designated items are required to be reported in earnings in the current period. This Topic also establishes presentation and disclosure requirements for similar types of assets and liabilities measured at fair value.

As required by FASB ASC Topic No. 350, for goodwill and other intangibles impairment analysis, we utilize fair value measurements which are categorized within Level 3 of the fair value hierarchy.

At December 31, 2018 and 2017, the carrying value and the aggregate fair value of the Company’s short and long-term debt were as follows (in thousands):

| | As of December 31, 2018 | | As of December 31, 2017 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Liabilities: | | | | |
| Short-term debt - related party | $ — | $ — | $1,000 | $1,000 |
| Long-term debt - related party | — | — | 1,200 | 1,200 |
| Long-term debt | — | — | 1,558 | 1,558 |
| Total long-term debt | $ — | $ — | $3,758 | $3,758 |

The carrying value of $3.8 million is net of debt discount of $0.4 million and debt issuance costs of $0.1 million as of December 31, 2017.

Significant Concentrations

For the year ended December 31, 2018, one customer, accounting for over 10% of revenues, made up 81% of revenues and 82% of accounts receivable, and one service provider with more than 10% of purchases totaled 21% of accounts payable. For the year ended December 31, 2017, two customers, each accounting for over 10% of revenues, made up 75% of revenues and 72% of accounts receivable, and one service provider with more than 10% of purchases totaled 11% of accounts payable.

Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash, government securities, mutual funds, and money market funds. These securities are primarily held in two financial institutions and are uninsured except for the minimum Federal Deposit Insurance Corporation coverage, and have original maturity dates of three months or less. As of December 31, 2018 and 2017, bank balances totaling approximately $11.8 million and $2.0 million, respectively, were uninsured.

Accounts Receivable and Allowance for Doubtful Accounts

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

Equipment and Improvements

Equipment and improvements are stated at cost. Depreciation is computed using the straight-line method based on the estimated useful lives of the assets, generally ranging from three to seven years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful life of the asset or the lease term.

Internal Software Development Costs

Development costs incurred in the research and development of new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. The Company considers technological feasibility to be established when all planning, designing, coding, and testing has been completed according to design specifications. After technological feasibility is established, any additional costs are capitalized. Through December 31, 2018, software has been substantially completed concurrently with the establishment of technological feasibility; accordingly, no costs have been capitalized to date.

Impairment or Disposal of Long Lived Assets

Long-lived assets to be held are reviewed for events or changes in circumstances which indicate that their carrying value may not be recoverable. They are tested for recoverability using undiscounted cash flows to determine whether or not impairment to such value has occurred as required by FASB ASC Topic No. 360, Property, Plant, and Equipment. The Company determined there was an impairment of its Customer Relationships intangible asset in the amount of $0.4 million as of December 31, 2016.

Goodwill

In accordance with FASB ASC Topic No. 350, Intangibles-Goodwill and Other, we review the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. The Company's annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the fair value of the Company's reporting units to the carrying value of the underlying net assets in the reporting units. If the fair value of a reporting unit is determined to be less than the carrying value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the fair value of the reporting unit and the fair value of its other assets and liabilities.

Intangible Assets and Amortization

Amortization expense related to other intangibles acquired in acquisitions is calculated on a straight line basis over two to six years. Intangible assets are tested for impairment if events or circumstances occur indicating that the respective asset might be impaired.

Derivatives

The Company analyzes all financial instruments with features of both liabilities and equity under FASB ASC Topic No. 480, Distinguishing Liabilities from Equity and FASB ASC Topic No. 815, Derivatives and Hedging. Derivative liabilities are adjusted to reflect fair value at each period end, with any increase or decrease in the fair value being recorded in results of operations as adjustments to fair value of derivatives. The effects of interactions between embedded derivatives are calculated and accounted for in arriving at the overall fair value of the financial instruments.

Going Concern Evaluation

In connection with preparing consolidated financial statements for the year ended December 31, 2018, management evaluated whether there were conditions and events, considered in the aggregate, that raised substantial doubt about the Company's ability to continue as a going concern within one year from the date that the financial statements are issued.

The Company considered the historical operating loss and negative cash flow from operating activities trends, including the positive trends occurring in the recent year.

The Company evaluated its ability to meet its obligations as they become due within one year from the date that the financial statements are issued by considering the following:

- In May 2017, the Company raised $2.2 million of new capital in a private placement offering of its common stock.
- In September 2017, the Company closed on a $5.5 million preferred stock transaction which converted $2.8 million of long and short-term debt, and raised $2.7 million of new capital.
- On March 5, 2018, the Company raised $5.0 million of new capital in a private placement offering of its common stock.
- On May 3, 2018, the Company raised $7.0 million of new capital in a private placement offering of its common stock.
- On November 7, 2018, the Company raised $7.5 million of new capital in a private placement offering of its common stock. Following this transaction, $3.2 million of short and long-term debt was repaid.

In addition to the recent capital raised, management also believes that the Company will generate enough cash from operations to satisfy its obligations for the next twelve months from the issuance date.

The Company will take the following actions if it starts to trend unfavorably to its internal profitability and cash flow projections, in order to mitigate conditions or events that would raise substantial doubt about its ability to continue as a going concern:

- Raise additional capital through short-term loans.
- Implement additional restructuring and cost reductions.
- Raise additional capital through a public or private placement.
- Secure a commercial bank line of credit.
- Dispose of one or more product lines.
- Sell or license intellectual property.

Revenue Recognition

The Company adopted FASB ASC Topic No. 606, Revenue from Contracts with Customers, as of January 1, 2018, and recognizes the sale of goods and services based on the five step analysis of transactions as provided in Topic 606 which requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for such goods and services.

In our Wireless segment, we transfer software licenses to our customers on a royalty free, non-exclusive, non-transferrable, limited use basis during the term of the agreement. In some instances, we perform customization services to ensure the software operates within our customer's operating platforms as well as the operating platforms of the mobile devices used by their end customers before transferring the license. Revenue related to these services is recognized at a point in time upon acceptance of the software license by the customer. We also earn usage based revenue on our platforms. Usage based revenue is generated based on active licenses used by our customer's end customers, the provision of hosting services, revenue share based on media placements on our platform, and use of our Cloud Based services. We recognize our usage based revenue when we have completed our performance obligation and have the right to invoice the customer. This revenue is generally recognized monthly or quarterly.

We also provide consulting services to develop customer specified functionality that are generally not on our software development roadmap. We recognize revenue from our consulting services upon delivery and acceptance by the customer of our software enhancements and upgrades. For certain Wireless segment customers we provide maintenance and technology support services for which the customer pays upfront or as we provide the services. When the customer pays upfront, we record the payments as contract liabilities and recognize revenue ratably over the contract period as this is our stand ready performance obligation that is satisfied ratably over the maintenance and technology services period.

In our Graphics segment where we sell off-the-self software products with no customization or post sale technology support services, we recognize revenue at the time we transfer control of the product to the customer. This occurs upon shipment of the product or when the customer downloads the software from our website or website of our resellers. We offer a 30 day return option to our customers; a return reserve is established at the time revenue is recorded and the reserve is monitored and adjusted based on actual experience. Historically, returns have been insignificant.

Product and Services Warranties

Warranty related costs are recorded in our operating expenses as incurred as these costs are immaterial for the products and services we sell.

Shipping and Handling Costs

We incur shipping and handling costs as part of our Graphics software sales. These costs are treated as fulfillment costs and are expensed as incurred.

Principal and Agent Considerations

We own the Intellectual Property and retain ownership when we license our customized software solutions for use by our Wireless segment customers. We are a principal in these transactions and as such we recognize our Wireless segment revenue on a gross basis.

We sell our Graphics software products directly to end consumers as well as through our distributors and re-sellers. We are a principal in these transactions as we bear the inventory risk, customers (or customer's end users) view us as

the primary obligor responsible for supporting the software products, and we have full

discretion in establishing the prices for our graphics software products. As a principal we record our Graphics segment revenue on a gross basis.

Sales Incentives

For our Graphics sales, the cost of sales incentives the Company offers without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction is accounted for as a reduction of revenue as required by FASB ASC Topic No. 605-50, Revenue Recognition-Customer Payments and Incentives. We use historical redemption rates to estimate the cost of customer incentives. Total sales incentives were $0.1 million and $0.3 million for the years ended December 31, 2018 and 2017, respectively.

Stock-Based Compensation

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

Recently Adopted Accounting Pronouncements

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (Topic 350) Simplifying the Test for Goodwill Impairment, which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, under the ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The ASU is effective prospectively for fiscal years beginning after December 31, 2019, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company elected to early adopt ASU 2017-04 during 2017 for its annual goodwill impairment test. There was no impact of adoption of ASU 2017-04 on the consolidated financial statements.

In July 2017, the FASB issued ASU No. 2017-11, Earnings Per Share (Topic 260) Distinguishing Liabilities from Equity (Topic 480) Derivatives and Hedging (Topic 815), which changes the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity’s own stock. ASU 2017-11 is effective for annual and interim periods beginning after December 15, 2018, and early adoption is permitted, including adoption in an interim period. The Company elected to early adopt ASU 2017-11 during 2017 by applying ASU 2017-11 retrospectively to outstanding financial instruments with a round down feature for each prior reporting period presented, as well as a cumulative-effect adjustment to the Company’s beginning accumulated deficit as of January 1, 2017.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 clarifies the principles for recognizing revenue when an entity either enters into a contract with customers to transfer goods or services or enters into a contract for the transfer of non-financial assets. The Company adopted ASU 2014-09 as of January 1, 2018 utilizing the modified retrospective approach. This adoption did not have a material impact on our consolidated financial statements. See Note 11 for further details.

Recently Issued Accounting Standards Not Yet Adopted

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or

retrospectively using a cumulative effect adjustment in the year of adoption. The Company is evaluating the impact of this guidance on our consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820), which is designed to improve the effectiveness of disclosures related to fair value measurements. This ASU is effective for annual periods beginning after December 15, 2019 and early adoption is allowed in any interim reporting periods within those annual reporting periods. The Company is currently assessing the impact that this ASU will have on its consolidated financial statements.

2. Acquisitions (Unaudited)

In December 2018, the Company entered into a definitive agreement to acquire the net assets of ISM Connect, LLC's Smart Retail product Suite ("Smart Retail"). The transaction closed on January 9, 2019.

The following table summarizes the consideration paid for the Smart Retail acquisition in 2019 (in thousands):

| | |
|---|---|
| Fair value of assets acquired | $9,315 |
| Fair value of liabilities assumed | 212 |
| Total purchase price | $9,103 |
| | |
| Components of purchase price: | |
| Cash | $3,974 |
| Common stock | 5,129 |
| Total purchase price | $9,103 |

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

| | |
|---|---|
| Assets: | |
| Costs incurred on projects not complete | $48 |
| Intangible assets | 5,229 |
| Goodwill | 4,038 |
| Total assets | $9,315 |
| Liabilities: | |
| Deferred revenue | $212 |
| Total liabilities | 212 |
| Total purchase price | $9,103 |

The purpose of the Smart Retail acquisition was to acquire a new growing and profitable revenue stream while deepening the relationships with our customers. The Smart Retail platform, which the Company will call ViewSpot™ , enables wireless carriers and retailers to offer powerful on-screen, interactive device demos that deliver consistent, secure and targeted content that showcase the features of the devices that consumers what to see and learn more about. ViewSpot also provides analytics capabilities, which will allow customers to gain valuable insights and buying behaviors. The platform is a logical addition to the Company's existing product line that reaches wireless carriers and provides them with services that can attract and retain customers.

Unaudited pro forma results of operations (in thousands, except per share data) for the year ended December 31, 2018 are included below as if the acquisition occurred on January 1, 2018. Fiscal year 2017 financial information for Smart Retail is not available; therefore, pro forma results of operations for 2017 have not been provided. This summary of the unaudited pro forma results of operations is not necessarily indicative of what the Company's results of operations would have been had Smart Retail been acquired at the beginning of 2018, nor does it purport to represent results of operations for any future periods.

| | |
|---|---|
| Revenues | $30,086 |
| Net loss | (1,421) |
| Loss per share: | |
| Basic | $(0.08) |
| Diluted | $(0.08) |

The Company did not engage in any acquisitions during 2017.

3. Equipment and Improvements

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

| | December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Computer hardware, software, and equipment | $14,683 | $14,617 |
| Leasehold improvements | 5,316 | 5,316 |
| Office furniture and fixtures | 962 | 962 |
| | 20,961 | 20,895 |
| Less accumulated depreciation and amortization | (20,096) | (19,666) |
| Equipment and improvements, net | $865 | $1,229 |

Depreciation and amortization expense on equipment and improvements was $0.5 million and $0.7 million for the years ended December 31, 2018 and 2017, respectively.

4. Goodwill and Intangible Assets

The following table sets forth our acquired intangible assets by major asset class as of December 31, 2018 and December 31, 2017 (in thousands except for useful life data):

| | | December 31, 2018 | | | | December 31, 2017 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Useful life (years) | Gross | Accumulated amortization | Net book value before impairment | Impairment charge in 2016 | Net book value | Gross | Accumulated amortization | Net book value before impairment | Impairment charge in 2016 | Net book value |
| Purchased | 5-6 | $265 | $ (125) | $ 140 | $ — | $140 | $265 | $ (78) | $ 187 | $ — | $187 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| technology | | | | | | | | | | | |
| Customer relationships | 3-6 | 999 | (499) | 500 | (411) | 89 | 999 | (324) | 675 | (411) | 264 |
| Trademarks/trade names | 2 | 38 | (38) | — | — | — | 38 | (28) | 10 | — | 10 |
| Non-compete | 3 | 51 | (42) | 9 | — | 9 | 51 | (25) | 26 | — | 26 |
| Total | | $1,353 | $ (704) | $ 649 | $ (411) | $238 | $1,353 | $ (455) | $ 898 | $ (411) | $487 |

Intangible assets amortization expense was $0.2 million and $0.3 million for the years ended December 31, 2018 and 2017, respectively.

Future amortization expense related to intangible assets as of December 31, 2018 are as follows (in thousands):

| Year Ending December 31, | |
|---|---|
| 2019 | 143 |
| 2020 | 47 |
| 2021 | 40 |
| 2022 | 8 |
| Total | $238 |

Valuation of Goodwill and Intangible Assets

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

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

If the intangible assets are considered to be impaired, the impairment we recognize is the amount by which the carrying value of the intangible assets exceeds the fair value of the intangible assets. In addition, we base the useful lives and the related amortization expense on our estimate of the useful life of the intangible assets. Due to the numerous variables associated with our judgments and assumptions relating to the carrying value of our intangible assets and the effects of changes in circumstances affecting these valuations, both the precision and reliability of the resulting estimates are subject to uncertainty, and as additional information becomes known, we may change our estimate, in which case, the likelihood of a material change in our reported results would increase. The Company recognized an impairment loss of $0.4 million in the three and twelve months ended December 31, 2016 related to an intangible asset acquired from our Birdstep acquisition.

We review the recoverability of the carrying value of goodwill at least annually or whenever events or circumstances indicate a potential impairment. Our annual impairment testing date is December 31. Recoverability of goodwill is determined by comparing the estimated fair value of our reporting units to the carrying value of the underlying net assets in the reporting units. If the estimated fair value of a reporting unit is determined to be less than the fair value of its net assets, goodwill is deemed impaired and an impairment loss is recognized to the extent that the carrying value of goodwill exceeds the difference between the estimated fair value of the reporting unit and the fair value of its other assets and liabilities. We determined that we did not have any impairment of goodwill at December 31, 2018.

5. Debt and Related Party Transactions

Short-term Debt

On February 7, 2017, the Company entered into a short-term secured borrowing arrangement with William W. and Dieva L. Smith (“Smith”) and on February 8, 2017 entered into a short-term secured borrowing arrangement with Steven L. and Monique P. Elfman (“Elfman”) pursuant to which Smith and Elfman each loaned to the Company $1.0 million and the Company issued to each of them a Secured Promissory Note (the “Original Notes”) bearing interest at the rate of 18% per annum. The Original Notes were due on March 24, 2017 and were secured by the Company’s

accounts receivable and certain other assets. William W. Smith, Jr. is the Company's Chairman of the Board, President and Chief Executive Officer, and Steven L. Elfman is a director of the Company. On March 25, 2017, the Company entered into an Amendment to the Original Note issued to Smith that extended the Maturity Date of the Note to June 26, 2017. On March 31, 2017, the Company entered

into a new short-term secured borrowing arrangement with Elfman for $1.0 million which matured on June 23, 2017.

On June 30, 2017, the Company entered into a new short-term secured borrowing arrangement with each of Smith and Elfman to refinance the prior arrangement with each of them, which matured on June 26, 2017 and June 23, 2017, respectively. Under the new borrowing arrangements, the Company issued to each of Smith and Elfman a new Secured Promissory Note ("Replacement Notes") with a principal balance of $1.0 million, bearing interest at the rate of 12% per annum, and maturing on September 25, 2017. The maturity date of the Replacement Note entered into with Smith may be extended by up to 180 days upon the mutual consent of the Company and Smith. Each of the Replacement Notes were secured by the Company's accounts receivable and certain other assets.

On August 18, 2017, the Company entered into Amendments to the Replacement Notes issued to each of Smith and Elfman, which extended the Maturity Date of the Replacement Notes from September 25, 2017 to January 25, 2018. The amendments did not change any other terms of the Replacement Notes.

On August 23, 2017, the Company entered into a borrowing arrangement with Smith, under which the Company borrowed $0.8 million and issued to Smith a Secured Promissory Note, bearing interest at the rate of 12% per annum, and maturing on January 25, 2018.

On August 24, 2017, the Company entered into a new borrowing arrangement with Andrew Arno ("Arno"), under which the Company borrowed $0.3 million and issued to Arno new Secured Promissory Notes with an aggregate principal balance of $0.3 million, bearing interest at the rate of 12% per annum, and maturing on January 31, 2018. Andrew Arno is a director of the Company.

On January 30, 2018, the Company amended certain of its existing Secured Promissory Notes (the "Notes") for the sole purpose of extending the relevant maturity dates. The Note dated August 18, 2017 issued to Steven L. Elfman and Monique P. Elfman was amended to extend its maturity date to February 11, 2018 and was subsequently paid in full. The Note dated June 26, 2017 issued to William W. Smith, Jr. and Dieva L. Smith was amended to extend its maturity date to July 25, 2018. The Notes dated August 24, 2017 issued to Next Generation TC FBO Andrew Arno IRA 1663 and Andrew Arno were amended to extend the maturity date of each to July 25, 2018.

As a condition to closing of the private placement offering in March 2018 discussed in Note 6, the following Notes were further amended for the sole purpose of extending the maturity dates of each to March 25, 2020: (i) Secured Promissory Note dated June 26, 2017, issued to William W. Smith and Dieva L. Smith, as amended; (ii) Secured Promissory Note dated August 24, 2017, issued to Next Generation TC FBO Andrew Arno IRA 1663, as amended; and (iii) Secured Promissory Note, dated August 24, 2017 issued to Andrew Arno, as amended.

On September 29, 2017, the Company exchanged shares of the Company's newly designated Series B 10% Convertible Preferred Stock ("Series B Preferred Stock") for outstanding short-term indebtedness with a principal amount of $0.8 million owed to Smith and $0.1 million to Arno for 750 and 50 shares, respectively. See Note 6, Equity Transactions, for further details on the Series B Preferred Stock Offering.

The Company reviewed FASB ASC Topic No. 470-50, Debt Extinguishment, to evaluate the debt extinguishment gain incurred from the debt to equity transaction. Upon completion of the evaluation, it was determined that the gain associated with the short-term related party loan extinguishment to Preferred Stock should be accounted for as a capital contribution and was recorded to Stockholder's Equity. The principal balance of the note and resulting fair value of the equity interest exchanged was $0.8 million. The fair value was reduced by allocated legal fees and other direct issuance costs of $0.1 million, resulting in a net fair value of $0.8 million. The capital contribution related to the gain was the difference between these two amounts, or $0.1 million.

The Company evaluated the refinancing of the short-term debt instruments under FASB ASU Topic No. 470-60, Troubled Debt Restructurings, to determine whether the modification of the debt instruments would be considered a troubled debt restructuring, using the two-step decision tree. The two steps included an assessment of whether the Company is experiencing financial difficulties and if the creditors have provided concessions. Upon completion of this review, the Company concluded that the refinancing did not qualify as a troubled debt restructuring.

Long-term Debt

On September 2, 2016, we entered into a Note and Warrant Purchase Agreement with Unterberg Koller Capital Fund L.P. and William W. and Dieva L. Smith (collectively, the "Investors"), pursuant to which the Company issued and sold to the Investors in a private placement senior subordinated promissory notes in the aggregate principal amount of $4.0 million (the "Notes"). The Company completed the transactions contemplated by the Note and Warrant Purchase Agreement and issued the Notes on September 6, 2016. The Notes were to mature three years following the issuance date, or September 6, 2019, and bear interest at the rate of 10% of the outstanding principal balance of the Notes, payable quarterly in cash or shares of the Company's common stock.

On September 29, 2017, the Company exchanged shares of the Company's newly designated Series B 10% Convertible Preferred Stock for outstanding long-term indebtedness with a principal amount of $2.0 million owed to Smith for 2,000 of the Series B Preferred Stock. See Note 6, Equity Transactions, for further details on the Series B Preferred Stock Offering.

The Company reviewed FASB ASC Topic No. 470-50, Debt Extinguishment, to evaluate the debt extinguishment loss incurred from the transaction. Upon completion of the evaluation, it was determined that the loss associated with the long-term related party loan extinguishment to Preferred Stock should be accounted through the Statement of Operations. The principal balance of the note and resulting fair value of the equity interest transferred was $2.0 million. The fair value was reduced by legal fees and other direct issuance costs of $0.1 million. The net carrying amount of the long-term note was $1.5 million, which was net of debt issuance costs of $0.1 million and discount of $0.4 million.

In November 2018, the $2.0 million Unterberg Koller Note was paid in full, and an extinguishment loss consisting of the unamortized debt discount and issuance costs totaling $0.2 million was recognized.

The Company evaluated the conversion of the long-term debt under FASB ASU Topic No. 470-60, Troubled Debt Restructurings, for determining whether the modification of the debt instruments would be considered a troubled debt restructuring, using the two-step decision tree. The two steps included an assessment of whether the company is experiencing financial difficulties and if the creditors have provided concessions. Upon completion of this review, the Company concluded that the refinancing did not qualify as troubled debt restructuring.

6. Equity Transactions

Preferred Stock Offering

On September 29, 2017, the Company entered into a Securities Purchase Agreement with several investors for the issuance and sale (the "Offering") of 5,500 shares of the Company's newly designated Series B 10% Convertible Preferred Stock (the "Series B Preferred Stock") at a stated value of $1,000 per share, for a total purchase price of $5.5 million. The Series B Preferred Stock is convertible into the Company's Common Stock at a conversion price of $1.14 per share, which was the closing bid price of the Common Stock on September 28, 2017, or 4,824,562 shares of Common Stock in the aggregate. The holders of Series B Preferred Stock are entitled to receive cumulative dividends out of funds legally available thereof at a rate of ten percent (10%) per annum, payable (i) when and as declared by the

Board of Directors, in quarterly installments on March 1, June 1, September 1 and December 1, (ii) upon conversion into Common Stock with respect the Series B Preferred Stock being converted, and (iii) upon redemption of the Series B Preferred Stock by the Company.

In the event that the trading price of the Company's Common Stock for 20 consecutive trading days (as determined in the Certificate of Designation) exceeds 400% of the then effective Conversion Price of the Series B Preferred Stock (initially set at $1.14), the Company may force conversion of the Series B Preferred Stock into shares of Common Stock or elect to redeem the Series B Preferred Stock for cash. In addition, upon the occurrence of certain triggering events, each holder of Series B Preferred Stock will have the right to require the Company to redeem such holder's shares for cash equal to the stated value plus accrued and unpaid dividends and liquidated damages, costs, expenses and other amounts due in respect of the Series B Preferred Stock, and with respect to certain other triggering events, each holder will have the right to increase the dividend rate on such holder's Series B Preferred Stock to twelve percent (12%) while such triggering event is continuing.

In the Offering, the Company raised gross cash proceeds of $2.7 million, and exchanged outstanding indebtedness with a principal amount of $2.8 million owed to Smith (both long and short-term debt) and $0.1 million owed to Arno for 2,750 and 50 shares, respectively. The Offering raised net cash proceeds of $2.5 million (after deducting the placement agent fee and expenses of the Offering). The Company intends to use the net cash proceeds from the Offering for working capital purposes. In connection with the Offering, the Company granted customary registration rights to investors with respect to the resale of shares of Common Stock issuable upon conversion of the Series B Convertible Preferred Stock.

In connection with the Offering, the Company entered into a Registration Rights Agreement with investors (the "Series B Registration Rights Agreement") under which the Company agreed to prepare and file a registration statement with the SEC within 30 days after closing of the Series B Transaction for the purpose of registering the resale of shares of common stock issuable upon conversion of the Series B Preferred Stock (the "Conversion Shares"). The Company agreed to use its reasonable best efforts to cause such resale registration statement to be declared effective by the SEC within 90 days after the closing of the Series B Transaction (120 days in the event the registration statement is reviewed by the SEC) and agreed to pay liquidated damages to the Series B Stockholders if such resale registration statement were not to become effective within the applicable time period. The Conversion Shares were included in the registration statement filed in connection with the March Offering, and such registration statement became effective on April 19, 2018, which was later than the deadline specified in the Series B Registration Rights Agreement, resulting in liquidated damage payments of $48 thousand to Series B Stockholders. Certain Series B Stockholders, including without limitation, Smith and Arno, waived their rights to receive such liquidated damage payments.

Common Stock Offerings

May 2017 Offerings

On May 16, 2017, the Company entered into subscription agreements with four accredited investors in a private placement pursuant to which the Company issued and sold to such investors an aggregate of 85,000 shares of its unregistered common stock at a price per share of $1.10.

On May 17, 2017, the Company completed a registered direct offering of 2,077,000 shares of its common stock, which realized gross proceeds of $2.3 million before deducting transaction fees and other expenses. Offering costs related to the transaction totaled $0.2 million, comprised of $0.1 million of transaction fees and $0.1 million of legal and other expenses, resulting in net proceeds of $2.1 million. The Company engaged Sutter Securities Incorporated ("Sutter") and Chardan Capital Markets, LLC ("Chardan") as co-placement agents in connection with the offering, and under the terms of the engagement paid the placement agents a cash placement fee and issued to the placement agents warrants to purchase shares of Common Stock equal to 5% of the number of shares sold through each of them, without duplication, at an exercise price per share equal to $1.21 (Sutter) and $1.155 (Chardan). The warrants have a term of five years and became exercisable beginning on November 18, 2017.

March 2018 Offering

On March 6, 2018, the Company completed the March Offering, wherein a total of 2,857,144 shares of the Company's common stock were issued at a purchase price of $1.75 per share, for a total purchase price of $5.0 million, with each investor also receiving a warrant to purchase up to a number of shares of common stock equal

to the number of shares of common stock purchased by such investor in the offering at an exercise price of $2.17 per share. The March Offering raised net cash proceeds of approximately $4.5 million (after deducting the placement agent fee and expenses of the March Offering). The Company used the net cash proceeds from the March Offering for working capital purposes, to fund required dividend payments, payment of principal and interest payments under short-term borrowing obligations, and payment of interest (but not principal) under long-term borrowing obligations.

The Company engaged Chardan as placement agent for the March Offering pursuant to an engagement letter agreement. The Company agreed to pay Chardan a cash placement fee equal to 8.0% of the gross proceeds of the March Offering, and issued to Chardan a warrant to purchase shares of common stock equal to 3.0% of the number of shares sold in the March Offering (the "Chardan Warrant"). The Chardan Warrant has an exercise price of $2.365 per share, a term of 5.5 years from the closing date of the March Offering, and otherwise has identical terms to the warrants issued to the investors in the March Offering.

Pursuant to the purchase agreement entered in connection with the March Offering (the "March Purchase Agreement"), the Company used its best efforts to cause the conversion of all shares of the Company's Series B 10% Convertible Preferred Stock (the "Series B Preferred Stock") into shares of common stock pursuant to the terms of the Company's Certificate of Designation (the "Certificate of Designation") with respect to the Series B Preferred Stock. In connection therewith, the Company entered into letter agreements with each of William W. Smith, Jr. ("Smith") and Andrew Arno ("Arno"), whereby each of Smith and Arno agreed to take certain action to convert the shares of Series B Preferred Stock held by them pursuant to terms outlined in the March Purchase Agreement, and further agreed that the shares of common stock issued upon such conversion shall not be subject to resale registration rights. Each of Smith and Arno completed the conversion of their shares of Series B Preferred Stock in accordance with such letter agreements.

The Company prepared and filed a registration statement with the SEC for the purpose of registering the resale of shares of common stock issued in the March Offering, and such registration statement became effective within the time period agreed by the parties to the March Offering.

The Company has outstanding warrants issued pursuant to an agreement entered into on September 6, 2016 with Unterberg Koller Capital Fund L.P. (the "Unterberg Warrant Agreement"). The March Offering caused a Triggering Event as defined in the Unterberg Warrant Agreement, and the warrants were repriced from an exercise price of $2.14 to $2.07. The Triggering Event charges of $11 thousand were recorded to Stockholders' Equity during the first quarter of 2018.

May 2018 Offering

On May 3, 2018, the Company completed the May Offering, wherein a total of 3,170,000 shares of the Company's common stock were issued at a purchase price of $2.21 per share, for a total purchase price of approximately $7.0 million, with each investor also receiving a warrant to purchase up to a number of shares of common stock equal to the number of shares of common stock purchased by such investor in the Offering at an exercise price of $2.11 per share. The May Offering raised net cash proceeds of approximately $6.3 million (after deducting the placement agent fee and expenses). The Company used the net cash proceeds from the May Offering for working capital purposes, and to fund required dividend payments, payment of principal and interest payments under short-term borrowing obligations, and payment of interest (but not principal) under long-term borrowing obligations.

The Company engaged Chardan as placement agent for the May Offering pursuant to an engagement letter agreement. The Company agreed to pay Chardan a cash placement fee equal to 7.0% of the gross proceeds of the May Offering. The Company also engaged Roth Capital Partners, LLC ("Roth") as its financial advisor for the May Offering. The Company agreed to pay Roth a cash fee equal to 2.0% of the gross proceeds of the May Offering.

The Company prepared and filed a registration statement with the SEC for the purpose of registering the resale of shares of common stock issued in the May Offering, and such registration statement became effective within the time

period agreed by the parties to the May Offering.

November 2018 Offering

On November 7, 2018, the Company completed the November Offering, wherein a total of 3,239,785 shares of the Company's common stock were issued at a purchase price of $2.32 per share, for a total purchase price of approximately $7.5 million, with each investor also receiving a warrant to purchase up to a number of shares of common stock equal to the number of shares of common stock purchased by such investor in the Offering at an exercise price of $2.20 per share.

As part of the November Offering, the previously issued warrant agreements from the March and May 2018 Offerings were amended, which allowed the Company to reclassify them from liability to equity treatment. These warrants were initially accounted for as liabilities under ASC 815-40-25 since the original warrants provided the investors a cash settlement option in the event of a fundamental transaction that was not also provided to the common stockholders. In connection with the November Offering, these warrants were amended to remove the cash settlement option in the event of a fundamental transaction, thereby allowing equity treatment.

The November Offering raised net cash proceeds of approximately $6.9 million (after deducting the placement agent fee and expenses). The Company is using the net cash proceeds for general corporate purposes and repaid certain short and long-term debt obligations of $3.2 million.

The Company engaged Chardan as placement agent for the November Offering pursuant to an engagement letter agreement. The Company agreed to pay Chardan a cash placement fee equal to 6.0% of the gross proceeds of the November Offering. The Company also engaged Roth as its financial advisor for the November Offering. The Company agreed to pay Roth a cash fee equal to 2.0% of the gross proceeds of the November Offering.

The Company prepared and filed a registration statement with the SEC for the purpose of registering the resale of shares of common stock issued in the November Offering, and such registration statement became effective within the time period agreed by the parties to the November Offering.

Warrants

On September 2, 2016, the Company entered into a Note and Warrant Purchase Agreement with the Investors, pursuant to which the Company issued and sold to the Investors in a private placement senior subordinated promissory notes in the aggregate principal amount of $4.0 million and five-year warrants to purchase an aggregate of 1,700,000 shares of the Company's common stock at an exercise price of $2.74 per share, which expires five years from the date of issuance. The Company completed the transactions contemplated by the Purchase Agreement and issued the Notes and Warrants on September 6, 2016. The terms of the warrants provide that if the Company sells or issues shares of common stock with an exercise price less than $2.74 per share, the exercise price shall be adjusted accordingly to the terms set forth in the Agreement, as discussed in greater detail in the following paragraph. We assessed the warrants and concluded that they should be recorded as equity.

Since the issuance of the warrants to the Investors (the "Smith Warrant" and the "Unterberg Warrant") on September 6, 2016, there have been five triggering events, causing the warrants to be repriced from the original exercise price of $2.74: Common Stock offerings in May 2017 for $1.10 and $1.05, the issuance of warrants to Sutter and Chardan with exercise prices of $1.21 and $1.155, respectively, all resulting in a charge of $3,000, and the Series B Preferred Stock issuance with a conversion price of $1.14 in September 2017, resulting in a charge of $41,000. The triggering event charges were recorded to Stockholders' Equity in the applicable period. Upon application of the triggering events above, the exercise price of the Unterberg Warrant was adjusted to $2.14 and the exercise price of the Smith Warrant was adjusted to $2.38, which is also the agreed upon floor for the Smith Warrants.

The Company issued warrants to purchase shares of Common Stock in connection with a registered direct offering completed in May 2017, March 2018, May 2018 and November 2018. See the prior section under the

F-20

heading “Common Stock Offering” for additional details regarding the warrants issued in connection with those offerings.

Subscription Agreement

On May 16, 2017, the Company entered into a subscription agreement with Andrew Arno (“Arno”) in a private placement pursuant to which the Company issued and sold 50,000 shares of its common stock at a price per share of $1.10. Andrew Arno is a director of the Company.

7. Income Taxes

Income (loss) before provision for income taxes was generated from the following sources (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Domestic | $(2,541) | $(7,132) |
| Foreign | (186) | (75) |
| Total loss before provision for income taxes | $(2,727) | $(7,207) |

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

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Current: | | |
| Federal | $(265) | $— |
| State | 2 | (1) |
| Foreign | 63 | 40 |
| Total current | (200) | 39 |
| Deferred: | | |
| Federal | 265 | (530) |
| State | — | — |
| Foreign | (52) | (55) |
| Total deferred | 213 | (585) |
| Total income tax expense (benefit) | $13 | $(546) |

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

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Federal statutory rate | 21.0 % | 35.0 % |
| State tax, net of federal benefit | 3.0 | 3.9 |
| Equity compensation | (0.7) | (4.5) |
| International tax items | (1.7) | (0.8) |
| Foreign taxes | (0.4) | 0.2 |
| State NOL true-up | (30.4) | 0.0 |
| Miscellaneous | (7.7) | (0.2) |
| Effect of change in rate | (12.6) | (372.4) |
| Change in valuation allowance | 29.0 | 346.4 |
| | (0.5)% | 7.6 % |

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

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Deferred income tax assets | | |
| Net operating loss carry forwards | $41,356 | $40,042 |
| Credit carry forwards | 3,292 | 3,557 |
| Fixed assets | 493 | 531 |
| Intangibles | 6,417 | 8,446 |
| Equity-based compensation | 439 | 399 |
| Nondeductible accruals | 565 | 465 |
| Various reserves | 55 | 81 |
| Other | 107 | 2 |
| Valuation allowance | (52,414) | (52,948) |
| Total deferred income taxes - net | 310 | 575 |
| Deferred income tax liabilities | | |
| Foreign intangibles | (74) | (126) |
| Unrealized translation gain/loss | (4) | (23) |
| Prepaid expenses | (41) | (22) |
| Total deferred income liabilities | (119) | (171) |
| | | |
| Net deferred income tax assets | $191 | $404 |

The Company has federal and state net operating loss ("NOL") carryforwards of approximately $159.0 million and $151.1 million, respectively, at December 31, 2018, to reduce future cash payments for income taxes. These federal NOL carryforwards will expire from 2024 through 2037 and state NOL carryforwards will expire 2018 through 2038. The Company also had $0.3 million of Alternative minimum tax credit carryforwards with an indefinite life, available to offset regular federal income tax requirements.

The Company has federal and state tax credit carryforwards of approximately $2.5 million and $0.7 million, respectively, at December 31, 2018. These tax credits will begin to expire in 2027.

To the extent that an ownership change has occurred under Internal Revenue Code Sections 382 and 383, the Company's use of its loss carryforwards and credit carryforwards to offset future taxable income may be limited.

At December 31, 2018 and 2017, the Company had unrecognized tax benefits, including interest and penalties, of approximately $0.4 million.

The Company's gross unrecognized tax benefits as of December 31, 2018 and 2017 and the changes in those balances are as follows (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Beginning balance | $428 | $428 |
| Increases (decreases) in tax positions for the | — | — |

| | | |
|---|---|---|
| current year | | |
| Increases (decreases) in tax positions for the prior year | — | — |
| Gross unrecognized tax benefits, ending balance | $428 | $428 |

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

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

In assessing whether a valuation allowance is required, significant weight is to be given to evidence that can be objectively verified. A significant factor in the Company's assessment is that the Company has been in a three-year historical cumulative loss as of the end of fiscal 2016. In addition, the Company was also in a loss position for the year ending December 31, 2017 as well as for the year ending December 31, 2018. These facts, combined with uncertain near-term market and economic conditions, reduced the Company's ability to rely on projections of future taxable income in assessing the realizability of its deferred tax assets.

After a review of the four sources of taxable income as of December 31, 2018 (as described above), and after consideration of the Company's continuing cumulative loss position as of December 31, 2018, the Company recorded a valuation allowance related to its U.S.-based deferred tax assets of $52.4 million at December 31, 2018. The valuation allowance on deferred tax assets decreased by $0.5 million and $23.7 million in 2018 and 2017, respectively. The decrease in valuation allowance is the result of valuation allowance being released in 2018 to allow recognition of the deferred tax assets related to AMT credits which will now be refundable under the Tax Cuts and Jobs Act beginning in 2018.

We recognized interest and penalties accrued related to unrecognized tax benefits in income tax expense. During 2018 and 2017, we recognized $0 and of interest and penalties. The cumulative interest and penalties at December 31, 2018 and 2017 were $0. Due to expiration of statute limitation of California R&D, the unrecognized tax benefits including interest and penalties were released during 2016. We do not anticipate any material changes to unrecognized tax benefits within the next twelve months that will affect the effective tax rate.

The Company is subject to U.S. federal income tax, as well as to income tax of multiple state jurisdictions. Currently there are no audits in process or pending from Federal or state tax authorities. The Company closed their federal audit of 2011 loss carry back claim during the 2014 tax year with no impact to the financial statements. The 2015-2017 tax years are open for federal audit. State income tax returns are subject to examination for a period of three to four years after filing, and currently the 2014-2017 tax years are open for audit. The outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. As of December 31, 2018, a current estimate of the range of changes that may occur within the next twelve months cannot be made due to the uncertainty regarding the timing of these events.

On December 22, 2017, the President signed the Tax Cuts and Jobs Act ("the 2017 Act") into law. The 2017 Act will have pervasive financial reporting implications for all companies with U.S. operations. We reviewed and incorporated the new tax bill implications in the 2017 financial statements. The main change is the remeasurement of deferred taxes at the new corporate tax rate of 21%, which reduced the net deferred tax assets, before valuation allowance, by $26.9 million. Due to full valuation allowance, the change in deferred taxes was fully offset by the change in valuation allowance.

For financial reporting purposes, income (loss) before provision for income taxes for our foreign subsidiaries was $(0.2) million and $(0.1) million for the years ended December 31, 2018 and 2017, respectively. At December 31, 2017, unremitted earnings of foreign subsidiaries were approximately $0.3 million and were included in our computation of the transition tax associated with the enactment of the Act discussed above. We do not provide for U.S. taxes on our unremitted earnings of foreign subsidiaries that have not been previously taxed since we intend to invest such undistributed earnings indefinitely outside of the U.S.

As a part of the provisions of the 2017 Act, the corporate alternative minimum tax ("AMT") has been repealed for tax years beginning after December 31, 2017. Taxpayers with AMT credit carryforwards that have not yet been used may claim a refund in future years for those credit. Since the AMT credit will now be fully refundable regardless of whether there is a future income tax liability before AMT credits, the benefit of the AMT credit will be realized in the future. Accordingly, a valuation allowance established against AMT credit carryforward balance is no longer necessary and a benefit has been recognized with respect to a $0.5 million AMT credit carryforward balance that was generated with 2011 net operating loss carrybacks. The Company has opted to reflect the balance as part of deferred tax asset balance. With the filing of the 2018 federal tax return, the Company will receive a refund of 50% of the balance and this amount has been reclassified to a federal income tax receivable.

The 2017 Act subjects a U.S. shareholder to current tax on global intangible low-taxed income ("GILTI") earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740 No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred. We have elected to recognize the tax on GILTI as a period expense in the period the tax is incurred. The current income related to the GILTI inclusion in 2018 is less than $0.1 million.

8. Net Loss Per Share

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

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (in thousands, except per share amounts) | |
| Numerator: | | |
| Net loss | $(2,740) | $(6,661) |
| Dividends paid to preferred stockholders | (404) | — |
| Net loss available to common stockholders | $(3,144) | $(6,661) |
| Denominator: | | |
| Weighted average shares outstanding - basic | 22,322 | 13,489 |
| Potential common shares - options (treasury stock method) | — | — |
| Weighted average shares outstanding - diluted | 22,322 | 13,489 |
| Shares excluded due to an exercise price greater than weighted average stock price for the period | 1,081 | 1,839 |
| Net loss per common share: | | |
| Basic | $(0.14) | $(0.49) |
| Diluted | $(0.14) | $(0.49) |

9. Employee Benefit Plans

The Company offers its employees participation in a 401(k) plan, in which the Company matches the employee contributions at a rate of 20%, subject to a vesting schedule. Total employer contributions amounted to $0.1 million and $0.2 million for the years ended December 31, 2018 and 2017, respectively.

10. Stock-Based Compensation

Stock Plans

On June 18, 2015, our Shareholders approved the 2015 Omnibus Equity Incentive Plan (“2015 OEIP”) and a subsequent amendment to the 2015 OEIP to increase the number of shares reserved thereunder was approved by our Shareholders on June 14, 2018. The 2015 OEIP, which became effective upon approval by our Shareholders on June 18, 2015, replaced the 2005 Stock Option / Stock Issuance Plan (“2005 Plan”) which was due to expire on July 28, 2015. All outstanding options under the 2005 Plan remain outstanding, but no new grants will be made under the 2005 Plan. The maximum number of shares of the Company’s common stock available for issuance over the term of the 2015 OEIP may not exceed 4,625,000 shares.

The 2015 Plan provides for the issuance of full value awards (restricted stock, performance stock, dividend equivalent right or restricted stock units) and partial value awards (stock options or stock appreciation rights) to employees, non-employee members of the board and consultants. Any full value award settled in shares will be debited as 1.2 shares, and partial value awards settled in shares will be debited as 1.0 shares against the share reserve. The exercise price per share for stock 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. Stock 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 stock options terminate and all vested stock options may be exercised within a period of 90 days following termination. In general, stock 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.

Employee Stock Purchase Plan

The Company has a shareholder approved employee stock purchase plan (“ESPP”), under which substantially all employees may purchase the Company’s common stock through payroll deductions at a price equal to 85% of the lower of the fair market values of the stock as of the beginning and end of six-month offering periods. An

employee's payroll deductions under the ESPP are limited to 10% of the employee's compensation and employees may not purchase more than the lesser of $25,000 of stock, or 250 shares, for any purchase period. Additionally, no more than 250,000 shares in the aggregate may be purchased under the plan.

Stock Compensation Expense

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

Valuation of Stock Option and Restricted Stock Awards

The assumptions used to compute the share-based compensation costs for the stock options granted during the year ended December 31, 2018, using the Black-Scholes option pricing model, were as follows:

| | |
|---|---|
| Weighted average grant date fair value of stock options | $1.56 |
| Assumptions | |
| Risk-free interest rate (weighted average) | 2.90% |
| Expected dividend yield | — |
| Weighted average expected life (years) | 6.2 |
| Volatility (weighted average) | 73.8% |
| Forfeiture rate | 26.6% |

There were no stock options granted during 2017.

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

Valuation of ESPP

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

| Offering Period Ended | September 30, 2018 | March 31, 2018 | September 30, 2017 | March 31, 2017 |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Shares purchased for offering period | 1,843 | 3,250 | 2,000 | 2,002 |
| Fair value per share | $ 0.96 | $0.75 | $ 0.35 | $0.72 |
| Assumptions | | | | |
| Risk-free interest rate (average) | 2.29 % | 1.92 % | 0.89 % | 0.47 % |
| Expected dividend yield | — | — | — | — |
| Weighted average expected life (years) | 0.5 | 0.5 | 0.5 | 0.5 |
| Volatility (average) | 54.3 % | 81.4 % | 64.2 % | 52.6 % |

Compensation Costs

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

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Cost of revenues | $— | $1 |
| Selling and marketing | 112 | (23) |
| Research and development | 207 | 213 |
| General and administrative | 616 | 582 |
| Restructuring expense | — | 398 |
| Total non-cash stock compensation expense | $935 | $1,171 |

Stock Options

A summary of the Company's stock options outstanding under the 2015 OEIP and 2005 Plan as of December 31, 2018 and the activity during the years ended herein are as follows (in thousands except per share amounts):

| | Shares | Weighted Ave. Exercise Price | Aggregate Intrinsic Value |
|---|---|---|---|
| Outstanding as of December 31, 2016 (307 options exercisable at a weighted average exercise price of $26.48) | 373 | $ 22.51 | $ — |
| Granted | — | $ — | |
| Exercised | — | $ — | |
| Canceled / expired | (234) | $ 32.54 | |
| Outstanding as of December 31, 2017 (116 options exercisable at a weighted average exercise price of $6.16) | 139 | $ 5.69 | $ — |
| Granted | 30 | $ — | |
| Exercised | — | $ — | |
| Canceled / expired | (9) | | |
| Outstanding as of December 31, 2018 | 160 | $ 4.88 | $ — |
| | | | |
| Exercisable as of December 31, 2018 | 123 | $ 5.64 | $ — |
| Vested and expected to vest at December 31, 2018 | 136 | $ 4.13 | $ — |

As of December 31, 2018, there was $1.8 million of unrecognized compensation costs related to non-vested stock options and restricted stock granted under the Plans. At December 31, 2018, there were 2.8 million and 0 shares available for future grants under the 2015 OEIP and 2005 Plan, respectively.

F-27

Restricted Stock Awards

A summary of the Company's restricted stock awards outstanding under the 2015 OEIP and 2005 Plan as of December 31, 2018, and the activity during years ended therein, are as follows (in thousands):

| | Number of shares | Weighted average grant date fair value |
|---|---|---|
| Unvested at December 31, 2016 | 434 | $ 4.30 |
| Granted | 88 | 1.11 |
| Vested | (329) | 3.98 |
| Canceled and forfeited | (26) | 2.70 |
| Unvested at December 31, 2017 | 167 | 3.49 |
| Granted | 1,125 | 1.92 |
| Vested | (283) | 2.52 |
| Canceled and forfeited | (2) | 0.83 |
| Unvested at December 31, 2018 | 1,007 | 2.01 |

11. Revenues

Adoption of ASU 2014-09, Revenue from Contracts with Customers (Topic 606)

We adopted ASU 2014-09 effective January 1, 2018 using the modified retrospective approach. Results for the period beginning after January 1, 2018 are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported in accordance with historical accounting under Topic 605. We have applied the new standard to all open contracts at the date of initial application. The cumulative adjustment to the opening accumulated deficit balance at January 1, 2018 was immaterial.

Revenue Recognition

We recognize sales of goods and services based on the five-step analysis of transactions as provided in Topic 606. For all contracts with customers, we first identify the contract which usually is established when a contract is fully executed by each party and consideration expected is expected to be received. Next we identify the performance obligations in the contract. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. We then determine the transaction price in the arrangement and allocate the transaction price, if necessary, to each performance obligation identified in the contract. The allocation of the transaction price to the performance obligations are based on the relative standalone selling prices for the goods and services contained in a particular performance obligation. The transaction price is adjusted for the Company's estimate of variable consideration which may include certain incentives and discounts, product returns, distributor fees, and storage fees. We evaluate the total amount of variable consideration expected to be earned by using the expected value method, as we believe this method represents the most appropriate estimate for this consideration, based on historical service trends, the individual contract considerations and our best judgment at the time. We include estimates of variable consideration in revenues only to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. We also generate the majority of our revenue on usage based fees which are variable and depend entirely on our customers use of perpetual licenses, transactions processed on our hosted environment, advertisement placements on our service platform, and activity on our cloud based service platform.

We have made accounting policy elections to exclude all taxes by governmental authorities from the measurement of the transaction price, and since our standard payment terms are less than one year, we have elected the practical expedient not to assess whether a contract has a significant financing component.

Performance Obligations

CommSuite and Netwise Revenue

In our Wireless segment, we sell our software solutions to major wireless network and cable operators. For our Netwise and CommSuite products, we may provide customization services for a fee to ensure our software solution can operate on their operating platforms and the operating platform of the mobile devices of our customer's end users. In addition, since the mobile device OEMs change their operating systems regularly, we provide maintenance services to ensure utility of the software license is not diminished for our customers. We consider the customization services, the software license, and maintenance services to maintain the utility of the software license for our customers as a single performance obligation. We provide the perpetual license on a royalty free basis. Revenue related to customization services, if charged, is recognized at a point in time upon delivery and acceptance of the customized software license by the customer.

To support the Netwise and CommSuite solutions, we also provide customers with our hosted environment and ASP services for the duration of the license term. We consider the provision of these services to be a separate performance obligation. In these transactions, the total consideration expected is variable. We do not estimate when the variable consideration will be recognized because the License Usage Based Fees, Hosting Service Fees and ASP Advertising Fees relate specifically to our efforts to transfer the services for a specified period (month or quarter) which are distinct from the services provided in other specified periods. Our customer's or the customer's end customer's usage occurs within the defined period, and the variability of our license, hosting and ASP fees is resolved in the specified period, and such fees earned are not subject to adjustment based on the activity in other periods.

We earn revenue from these services on a fixed fee per perpetual license usage on our hosted environment and advertising revenue share for advertisements placed by our customers on our platform. The usage fees are not earned until we transfer our software license to our customers. We recognize the usage based fees when we are entitled to the consideration earned for the distinct service period based on our customer's usage of our licenses, hosting services, and ASP advertising platform.

SafePath Cloud Based Services

Our SafePath solution is a hybrid Software as a Service offering. We consider the provision of the perpetual license and the cloud based platform as a single performance obligation. We provide the perpetual license on a royalty free basis and earn revenue based on a fixed fee usage of our cloud based services. We recognize the usage based fees when we are entitled to the consideration earned for the distinct service period based on our customer's usage of our cloud based services.

Consulting Services and Other

In our Wireless segment, we have developed a roadmap for adding new functionality to our products to extend the product lifecycle and expand our customer's use of the product on their networks. From time to time, we enter into consulting services arrangements with our customers to develop incremental functionality not included on our developmental roadmap. We earn revenue from our consulting services that is recognized at the time of delivery of the software when the services have been completed and control has been transferred to our customers.

We also enter into arrangements with certain customers to provide technology support services beyond the initial warranty period. Technology support services include e-mail and telephone support and unspecified rights to bug fixes available on a when-and-if available basis. We consider the provision of such technology support services to be a separate performance obligation. We generally bill in advance for a fixed term and recognize revenue from these arrangements ratably over the contractual term as we perform our services.

Graphics Segment Revenue

We sell our off-the-shelf Graphics software products directly to end users as well as through our distribution and reseller channel partners. These products require no customization and minimal post-sale technology support services. We recognize revenue from Software sales at the time we transfer control of the product to the customer. This occurs upon shipment of the product or when the customer downloads the software from our website or website of our distributor and resellers partners. In some instances, we will consign our Software products to a distributor or reseller. In those instances, we recognize revenue when the end consumer takes control of the product.

We offer a 30 day return policy to our customers; a return reserve is established at the time revenue is recorded. We review available retail channel information and make a determination of a return provision for sales made to distributors and retailers based on current channel inventory levels and historical return patterns. The return reserve is monitored and adjusted based on actual experience. Historically, returns have been insignificant.

Unearned Revenue

Unearned revenue represents amounts billed to customers for which revenue has not been recognized. Unearned revenue primarily consists of the unearned portion of monthly, quarterly and annually billed service fees and prepayments made by customers for a future period. We recognize revenue upon transfer of control. During the three and twelve months ended December 31, 2018 we recognized $0 and $48,000, respectively, in our consolidated statements of operations that was previously recorded as unearned revenue in the consolidated balance sheet at January 1, 2018.

Costs to Obtain a Customer Contract

We pay sales commissions to our sales force, which are incremental and recoverable costs of acquiring contracts. Sales commissions are only paid when we earn usage based fees on the contracts. The commission obligation is established each quarter based on the usage based fees earned. The commission obligation is not adjusted by future usage based fees earned, that is each period is discrete from the other. As a result of the structure of the commission plan, we record the commission expense when the commission obligation is determined, which is generally quarterly.

Costs to Fulfill a Customer Contract

We incur costs to fulfill obligations under a contract. We recognize these costs as we fulfill our performance obligation and recognize revenue. Where we provide services and earn revenue over the contract term based on usage of our platforms, we recognize the associated fulfillment costs as they are incurred and as usage based revenue is recognized.

Disaggregation of Revenues

We disaggregate revenue by our Wireless and Graphics segments.

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

| | For the Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| | (unaudited) | |
| Wireless: | | |
| CommSuite & Netwise | $18,889 | $14,521 |
| SafePath | 3,327 | 182 |
| Consulting services and other | 1,896 | 3,355 |
| Legacy software licenses | 362 | 284 |
| Total wireless | $24,474 | $18,342 |
| Graphics: | | |
| Software | 1,811 | 4,632 |
| Total revenues | $26,285 | $22,974 |

12. Commitments and Contingencies

Leases

The Company leases its buildings under operating leases that expire on various dates through 2022. Future minimum annual lease payments under such leases as of December 31, 2018 are as follows (in thousands):

| Year Ending December 31, | |
|---|---|
| 2019 | 2,085 |
| 2020 | 1,812 |
| 2021 | 1,776 |
| 2022 | 32 |
| Total | $5,705 |

As of December 31, 2018, $2.4 million of the remaining lease commitments expense has been accrued as part of the 2013 Restructuring Plan, partially offset by future estimated sublease income of $1.8 million.

Total rent expense was $1.7 million and $1.1 million for the years ended December 31, 2018 and 2017, respectively.

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

Pennsylvania Opportunity Grant Program

On September 26, 2011, we received $1.0 million from the State of Pennsylvania to help fund our agreement to start-up a new facility. The grant carried with it an obligation, or commitment, to employ at least 232 people within a three-year time period that ended on December 31, 2013. We received an extension of time to meet this employment

commitment by April 30, 2016. The grant contained conditions that would require us to return a pro-rata amount of the monies received if we failed to meet these conditions. As such, the monies had been recorded as a liability in the accrued liabilities line item on the balance sheet until we are irrevocably entitled to retain the monies, or until it is determined that we need to return a portion or all of the monies received. On June 27, 2016, we received a letter from the State of Pennsylvania requesting reimbursement of $0.3 million and said we earned the remaining $0.7 million of the original $1.0 million grant. On September 19, 2016, we entered into a Settlement and Release Agreement with the Commonwealth of Pennsylvania, acting by and through the Department of Community and Economic Development to repay $0.3 million of the original $1.0 million grant. Per the agreement, the total amount due of $0.3 million is at 0% interest and is payable in twenty equal quarterly installments commencing on January 31, 2017 and ending on October 31, 2021.

Litigation

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

Other Contingent Contractual Obligations

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

13. Segment, Customer Concentration and Geographical Information

Segment Information

Public companies are required to report financial and descriptive information about their reportable operating segments as required by FASB ASC Topic No. 280, Segment Reporting. The Company has two primary business units based on how management internally evaluates separate financial information, business activities and management responsibility. Wireless includes our NetWise®, CommSuite®, and SafePath® family of products. Graphics includes our consumer-based products: Poser®, Moho®, MotionArtist®, Rebelle, PhotoDonut and StuffIt®, and through April 2018 included third-party software products under the Clip Studio® brand, which we distributed under an agreement which expired in October 2017 and permitted certain post-termination distribution rights until April 2018.

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):

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Wireless | $24,474 | $18,342 |
| Graphics | 1,811 | 4,632 |
| Total revenues | 26,285 | 22,974 |

| | | |
|---|---|---|
| Cost of revenues | 4,333 | 5,082 |
| Gross profit | $21,952 | $17,892 |

Customer Concentration Information

A summary of the Company’s customers that represent 10% or more of the Company’s revenues is as follows:

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Wireless: | | |
| Sprint (& affiliates) | 81 % | 61 % |
| Graphics: | | |
| FastSpring | 5 % | 14 % |

The customers listed above comprised 84% and 72% of our accounts receivable as of December 31, 2018 and 2017, respectively. Our major customers could reduce their orders of our products in favor of a competitor's product or for any other reason. The loss of any of our major customers or decisions by a significant customer to substantially reduce purchases could have a material adverse effect on our business.

Geographical Information

During the years ended December 31, 2018 and 2017, the Company operated in three geographic locations: the Americas, EMEA (Europe, the Middle East, and Africa), and Asia Pacific. Revenues attributed to the geographic location of the customer’s bill-to address were as follows (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2018 | 2017 |
| Americas | $26,054 | $22,579 |
| EMEA | 90 | 170 |
| Asia Pacific | 141 | 225 |
| Total revenues | $26,285 | $22,974 |

14. Restructuring

In the fourth quarter of fiscal 2016, the Board of Directors approved a plan of restructuring intended to streamline and flatten the Company’s organization, reduce overall headcount by approximately 30%, and reduce its overall cost structure by approximately $2.5 million per quarter. The restructuring plan resulted in special charges totaling $0.3 million recorded during the three month period ended December 31, 2016. These charges were for primarily related to severance costs and were all paid out by December 31, 2016.

In the first quarter of fiscal 2017, the Board of Directors approved an additional restructuring plan intended to further streamline and flatten the Company’s organization, reduce overall headcount by approximately 16%, and reduce its overall cost structure by another $0.9 - $1.0 million per quarter. The restructuring plan resulted in special charges totaling approximately $0.3 million recorded during the three-month period ending March 31, 2017. These charges were primarily related to severance costs and include $0.1 million of non-cash stock-based compensation severance.

Restructuring charges in 2018 related to one-time employee termination costs.

Following is the activity in our restructuring liability for the year ended December 31, 2018 (in thousands):

| | Balance at December 31, 2017 | Provision, net | Usage | Balance at December 31, 2018 |
|---|---|---|---|---|
| Lease/rental terminations | $ 704 | — | (209) | $ 495 |
| One-time employee termination benefits | — | 173 | (59) | 114 |
| Total | $ 704 | $ 173 | $ (268) | $ 609 |

During the fourth quarter of 2017, the Company renewed and secured sublease contracts through the end of the lease expiration and consequently updated its future sublease assumptions resulting in $0.7 million of restructuring income on the consolidated statement of operations and comprehensive income.

15. Subsequent Events

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

On January 9, 2019, the Company acquired the net assets of ISM Connect, LLC's Smart Retail product suite. See Note 2 for additional information.

16. Quarterly Financial Data (Unaudited)

The following financial information reflects all normal recurring adjustments, which are, in the opinion of management, necessary for a fair statement of the results of the interim periods. Summarized quarterly data for fiscal 2018 and 2017 are as follows (in thousands, except per share data):

| | Year Ended December 31, 2018 | | | |
|---|---|---|---|---|
| | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
| Selected quarterly financial data: | | | | |
| Revenues | $5,463 | $6,945 | $6,525 | $7,352 |
| Gross profit | $4,154 | $5,829 | $5,546 | $6,424 |
| Operating income (loss) | $(2,021) | $74 | $55 | $679 |
| Net income (loss) | $(2,381) | $(2,177) | $(983) | $2,801 |
| Net earnings (loss) per share - basic (1) | $(0.16) | $(0.10) | $(0.04) | $0.10 |
| Weighted average shares outstanding - basic | 15,299 | 21,888 | 25,020 | 26,925 |
| Net earnings (loss) per share - diluted (1) | $(0.16) | $(0.10) | $(0.04) | $0.10 |
| Weighted average shares outstanding - diluted | 15,299 | 21,888 | 25,020 | 27,395 |

| | Year Ended December 31, 2017 | | | |
|---|---|---|---|---|
| | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
| Selected quarterly financial data: | | | | |
| Revenues | $5,576 | $5,862 | $5,804 | $5,732 |
| Gross profit | $4,293 | $4,577 | $4,645 | $4,377 |
| Operating loss | $(2,578) | $(1,619) | $(942) | $(535) |
| Net loss | $(2,880) | $(1,952) | $(1,670) | $(160) |
| Net loss per share - basic (1) | $(0.24) | $(0.15) | $(0.12) | $(0.01) |
| Weighted average shares outstanding - basic | 12,163 | 13,179 | 14,297 | 14,281 |
| Net loss per share - diluted (1) | $(0.24) | $(0.15) | $(0.12) | $(0.01) |
| Weighted average shares outstanding - diluted | 12,163 | 13,179 | 14,297 | 14,281 |

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