

SMITH MICRO SOFTWARE INC

Form 10-K

March 17, 2008

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**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, 2007**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 0-26536  
SMITH MICRO SOFTWARE, INC.  
(Exact name of registrant as specified in its charter)**

**Delaware**

(State or other jurisdiction of incorporation or  
organization)

**33-0029027**

(I.R.S. Employer Identification Number)

**51 Columbia, Suite 200, Aliso Viejo, CA**

(Address of principal executive offices)

**92656**

(Zip Code)

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

**Common Stock, \$.001 par value**

(Title of each class)

**The NASDAQ Stock Market LLC**

**(NASDAQ Global Market)**

(Name of each exchange on which registered)

**Securities registered pursuant to Section 12(b) of the Act: Common Stock, \$.001 par value**

**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

If this report is an annual or transition report, 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 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

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

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 29, 2007, 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 \$402,131,156 based upon the closing sale price of such stock as reported on the Nasdaq Global 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 13, 2008, there were 30,263,599 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement for the 2008 Annual Meeting of Stockholders to be filed under the Securities Exchange Act of 1934 are incorporated by reference in Part III of this report.

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**SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS**

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

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

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

*changes in demand for our products from our customers and their end-users;*

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

*the pace at which the market for new products develop;*

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

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

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

*those additional factors which are listed under the section 1A. Risk Factors beginning on page 11 of this report.*

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

Table of Contents**PART I****Item 1. BUSINESS****General**

Smith Micro Software, Inc. is a diversified developer and marketer of mobile software products and services. The primary strategic focus for our products and services is on wireless data communications; including software applications for broadband mobile networks, Wi-Fi, WiMAX, personal handset information management, managing mobile content on a handset, device management solutions, mobile image management and data compression solutions. We sell our products and services to many of the world's leading wireless service providers, original equipment manufacturers (OEM), device manufacturers, enterprise businesses and to consumers. Specific Smith Micro wireless software products include QuickLink Mobile, QuickLink Mobility, QuickLink IMS, QuickLink PhoneManager, QuickLink Music, QuickLink Media and StuffIt Wireless. The proliferation of 3G wireless technologies is providing new opportunities for our products and services on a global basis. When these broadband wireless technologies EVDO, UMTS, HSDPA and WiMAX are combined with new devices mobile phones, Personal Computers (PCs), smartphones, Personal Digital Assistants PDAs, and Ultra-Mobile PCs (UMPCs) opportunities emerge for new communications software products. Our core technologies are designed to address these emerging mobile convergence opportunities.

We offer software products that operate on Windows, Mac, UNIX, Linux, Windows Mobile, Symbian and Java platforms. The underlying design concept common across our products is based on the long-standing Smith Micro commitment to enhance the out-of-box user experience for our customer. We have over 25 years of experience in design, creation and custom engineering services for hardware and software products, and we have shipped over 70 million copies of our QuickLink family of products to customers worldwide.

Our operations are organized into four business groups: Connectivity and Security, Multimedia, Device Solutions and Consumer. We do not separately allocate operating expenses, nor do we allocate specific assets to these groups. Therefore, segment information reported includes only revenues and cost of revenues. See Note 13 of Notes to Consolidated Financial Statements for financial information related to our operating groups.

Today, the largest group within Smith Micro is the **Connectivity & Security Group**. This group's primary focus is to develop mobile connectivity and security solutions. QuickLink Mobile, the group's leading product, provides mobile users the ability to easily connect a notebook or other wireless devices to wireless wide area networks (WWANs) and Wi-Fi hotspots. Many of the largest wireless carriers worldwide including AT&T, Alltel, Orange, NTT DoCoMo, Sprint, T-Mobile, Verizon Wireless, Vodafone and others rely on QuickLink Mobile technology to help their subscribers easily connect to their wireless networks everyday. We also maintain strong relationships with leading device, hardware and infrastructure manufacturers including: UTStarcom, LG Electronics, Novatel, Kyocera, HTC, HP, and Siemens.

In addition to marketing products to wireless carriers and device manufacturers, the Connectivity & Security Group also delivers wireless mobility solutions to medium and large businesses. Our QuickLink Mobility and QuickLink Mobile Enterprise products are designed to address the security and mobility needs of an enterprise marketplace that is rapidly becoming more reliant on remote access to information using many types of wireless networks simultaneously. Our products deliver simplified data connectivity, and enhanced security when connecting wirelessly to corporate resources or the Internet. In addition to addressing the need for robust security, the QuickLink Mobility Enterprise suite allows for seamless and persistent connectivity for the user operating on Wireless Wide Area Networks (WWANs), corporate Local Area Networks (LANs) and Wi-Fi networks. The applications support most IP services and interoperate with approximately 200 carriers worldwide, hundreds of wireless devices, most of the popular broadband mobile cards and embedded WWAN PC notebook devices.

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Also in the Connectivity and Security Group, our Professional Services team supports our wireless mobility business direction. This area of business development leverages our many years of experience providing custom-tooled, web-based applications to support growing businesses. From basic web design to complex solutions involving complete customer management, online commerce and fulfillment services, the Professional Services Group helps businesses refine their processes and implement cost-effective web systems.

Our **Multimedia Group** develops innovative applications in the multimedia and PC phone tool spaces for wireless carriers. Today, the group ships music manager applications for PCs and mobile devices to leading wireless carriers such as Verizon Wireless, Sprint and Mexico-based IUSACELL. Building on this success, a logical next step is to add support on the PC for the management of photos, videos and applications that all reside on mobile devices. The group also launched its first multimedia product for the smartphone platform in late 2007 – Revue. Revue is a multimedia manager for the Windows Mobile platform which allows users to more easily manage and enjoy all their mobile multimedia content. The product comes with a PC companion application for syncing content between a PC and a smartphone.

Smith Micro has also pioneered a product suite known as Active Images, targeting the needs of OEM camera manufacturers. Active Images turns any JPEG file into a self-contained multimedia messaging system. Users can send text messages, music, sound files, documents and more – all in a single JPEG file. Watermarks, forms, music, Internet links, voice recordings, portable digital wallet information, and even videos can all be stored in a JPEG image and accessed on any device that has the Active Image thin client application installed. This technology plays directly into Smith Micro’s strategy of broadening its wireless product offerings and provides carriers and handset manufacturers enhanced music and photo management technology products. Our patented Active Images technology is used in several of our new product offerings including our photo management products which are bundled with products from camera manufactures and sold through leading retail distributors. Another new Active Images application is our Mobile Sweepstakes product, which creates a digital scratch card that can be sent to a mobile phone via MMS or to a PC via email.

Our third business segment – the **Device Solutions Group** – is focused on the mobile convergence space. We are developing solutions in the Firmware-Over-The-Air (FOTA) and IP Multimedia Subsystem (IMS) areas, and working to integrate our technologies into more mobile devices, networks and other developers’ applications. It is becoming both a smart and a connected world. Not only is there a need to update the firmware on mobile devices but FOTA updates also potentially applies to most other device types that have a built-in processor. These include automobiles, standard home appliances and entertainment devices, among others. A continuing initiative for our Device Solutions Group is StuffIt Wireless. StuffIt Wireless incorporates our patent pending JPEG compression technology that provides superior compression of multimedia data. This technology focuses on delivering image and resource compression for device manufacturers, increasing storage capacity anywhere from handsets to Internet sites. By compressing phone resources, we free up handset memory so that it can be reallocated to store more images, music or video files as economically as possible. We are currently in the prototype stage of product development with potential customers.

The fourth business unit is our **Consumer Group**. The core consumer business focuses on developing software for the PC utility and graphic markets. Smith Micro’s complete line of consumer and prosumer products is available through direct sales on the Smith Micro website, on partner websites, direct through customer service order desks and through traditional retail outlets. In addition, the Consumer Group also focuses on republishing and marketing third party software titles that complement our exiting line of products. The Consumer Group is focused on the following market segments: Compression, Graphics, Utilities (including Diagnosis, Performance, Security and Internet), Compilation and Lifestyle.

Today, the Consumer Group’s lead product line is StuffIt, which is driven by a patent pending, revolutionary JPEG compression technology. StuffIt provides superior compression, encryption and archive capability. This breakthrough technology can compress JPEG photos and images up to 30% without loss of image quality. In addition to compression technology, the company is focused on growing its line of graphic titles, in particular Poser, Anime Studio and Manga Studio. These lines of graphic products have a loyal following and are growing in market awareness.





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We do not separately allocate operating expenses, nor do we allocate specific assets to these groups. Therefore, segment information reported includes only revenues and cost of revenues.

Smith Micro is actively involved and maintains industry affiliations with leading groups such as Microsoft, Apple, Wi-Fi Alliance, OMA, GSM and CTIA to help develop industry standards and drive the proliferation of various wireless technologies.

Our research and development expenses amounted to \$14.8 million, \$7.9 million and \$4.0 million for the years ended December 31, 2007, 2006 and 2005, respectively. Our research and development expenses consist primarily of personnel and equipment costs required to conduct our software development efforts. We remain focused on the development and expansion of our technologies, particularly in the wireless, diagnostic, utility and Internet areas.

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

### **Industry Background**

Smith Micro offers products in the following technology and communications related markets:

*Wireless* To help drive revenue growth and profitability, wireless carriers have introduced new value-added products and services that coincide with a number of key enabling trends. Namely, traditional mobile devices are being replaced with multimedia-enabled devices, carriers are deploying wireless broadband network infrastructures and consumers are increasingly adopting mobile data and multimedia services. As carriers seek to enhance their competitive position, they have increasingly focused on network expansion, customer acquisition and customer service. This creates opportunities for Smith Micro, as carriers increase the use of third-party applications, services and custom solutions. These industry trends are the key drivers for the mobile data services market, which the Yankee Group has projected will grow from \$10.5 billion in 2005 to \$39.9 billion in 2010.

With IMS being deployed in service providers' networks around the globe and with a rich new set of wireless network options available for communication, significant changes are occurring in mobile handsets as well as the networks that support them. New intelligent handsets are being introduced to serve both Wi-Fi and cellular networks as well as VoIP. Smith Micro provides IMS software architecture for mobile devices.

*Mobile Music* Digital audio players and internet-based music download services have transformed music consumption into a personal and mobile experience. As wireless carriers seek to offer premium services and mobile devices support multimedia functionality, the market for digital music distribution over wireless networks and use on wireless devices is expected to grow rapidly. The Yankee Group, a leading industry forecasting organization, estimates that music-enabled mobile phone shipments worldwide will grow from 130.2 million units in 2005 to 882.7 million units in 2010, and IDC estimates that United States wireless subscribers who purchase full-track music delivered over cellular networks will grow from 9.7 million subscribers in 2006 to 54.3 million subscribers in 2010.

*Data Compression* Data compression is critical to both efficient data storage and multimedia transmission. As subscriber demand increases for mobile access to larger image, audio and video files, we believe wireless carriers and mobile device manufacturers face a pressing need to use better compression technologies to reduce the size of digital content sent over their networks and to maximize the efficient use of limited device memory. According to the Mobile Imaging Report, of the approximately 600 million digital cameras shipped in 2005, approximately 500 million were camera-enabled mobile phones.

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*Firmware Over The Air Software* Insignia Mobile Device Management (MDM) solutions deliver proven standards-based management for updating increasingly complex mobile devices. The product line offers both a client and server solution. The ability to deplot software to configure, update, diagnose, secure, and synchronize devices remotely results in significantly reduced customer care expenses. Greater control results in better customer service and a richly enhanced customer experience.

*Graphic Software* The fast growing global animation and 3D market reached nearly \$60 billion in sales in 2006 and is expected to pass the \$80 billion sales mark by 2010. Poser's 3D figure design and animation program, Manga Studio, originally created in Japan as ComicStudio, has become the number one selling Manga software worldwide. Anime Studio is a complete animation solution for creating 2D movies, cartoons, anime or cut-out animations and is ideal for animators of any caliber.

*Diagnostic & Utility Software* The growing prevalence and complexity of PC(s) and mobility operating systems require increasingly sophisticated diagnostic and utility software solutions to improve the consumers overall computing and mobile experience. Consumers demand products that can enhance PC performance, protect against spam, spyware and computer hacking and remove malicious code. Businesses need cross-platform solutions that can quickly identify and repair a broad range of computer-related problems. The Company's software solutions for Windows, Mac and Windows Mobility platforms perform diagnostic, maximize performance and help to protect consumer's online identity. The Company develops and republishes a growing line of products including Spring Cleaning, Anonymizer, CheckIt, Internet Cleanup and VMWare.

**Products and Services****Products**

Our primary product lines and products consist of the following:

| <b>Product Groups</b>   | <b>Products</b>   | <b>Description</b>   |
|-------------------------|---|--|
| Connectivity & Security | QuickLink Mobile<br>QuickLink Mobility<br>QuickLink WiMAX<br><br>QuickLink Configuration Server<br>QuickLink PhoneManager | Centralized connection management application to control, customize and automate wireless connections of all types. The products can include a Central Configuration Server for management software and firmware updates. The QuickLink Mobility Suite also includes a mobile VPN with session persistence for laptops and smart devices |
| Multimedia              | QuickLink Music<br>QuickLink Media<br>Revue<br>QuickLink PC Suite   | An intuitive music and multimedia manager to sync digital content to and from mobile devices. Revue is a multimedia application that resides on the Smartphone platform.   |
| Device Solutions        | StuffIt Wireless<br>StuffIt Image<br>Insignia<br>QuickLink IMS  | StuffIt Wireless enables compression of data files to facilitate storage in mobile devices and transmission over wireless networks; and file compression for   |

|          |   |  |
|----------|---|--|
|          |   | storage on Internet photo sites.<br>Insignia Device Management Suite allows you to intelligently manage a diverse population of mobile devices including the most advanced next-generation mobile phones and PDAs. |
| Consumer | StuffIt Deluxe<br>StuffIt Mobile<br>Anonymizer<br>CheckIt Registry<br>Spring Cleaning<br>Internet Cleanup<br>Poser<br>Anime Studio<br>Manga Studio<br>Personal Photo Manager<br>Aquazone<br>Revue | Utility & diagnostic solutions and graphics products   |

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Wireless carriers and mobile device manufacturers incorporate our products into their branded offerings, selling directly to their market segments. Our technologies are utilized in many major wireless networks to facilitate data communications via mobile devices, multimedia solutions, resource and file compression and FOTA. Our primary products include QuickLink Mobile, QuickLink Mobility, QuickLink Music, Insignia and StuffIt Wireless, as well as a variety of consumer products, which are described above.

*OEM Wireless.* QuickLink Mobile provides Windows, Mac, and Linux users with a centralized application to control, customize and automate wireless connections, including WWAN, Wi-Fi and WiMAX. In addition the Quickink Configuration Manager provides a server solution designed to manage deployment and configuration of the QuickLink Mobile connection manager. Our QuickLink Music technology allows users to purchase music from any compatible store(s), and transfer it to or from any music-capable mobile device. StuffIt Wireless offers carriers and mobile device manufactures a suite of image and file compression solutions. StuffIt Wireless enables image compression without loss of quality, thereby lowering demand on device resources. In addition, we have added resource compression to the product allowing device manufacture to compress phone management resources thus freeing up memory on the device to allow more multimedia files to be stored. Today the Insignia Mobile Device Management Suite is a client server solution to update mobile handset devices. We are positioning our technology to reach a much broader audience than just the updating of mobile handset devices and as more and more companies understand the true value inside our FOTA solutions, we believe we can expand into new market segments.

*Wireless Enterprise.* QuickLink Mobility is an enhanced version of QuickLink Mobile that has expanded security functionality, session persistence and a mobile VPN for enterprise environment. Additionally, QuickLink Mobility supports approximately 185 carriers worldwide and interoperates with many different types of mobile devices, PC Cards, USB modems and embedded modems.

*Consumer Products.* We also offer consumer products that provide compression, utility, diagnostic, and graphic development solutions. These products are designed to enhance PC performance, protect against spam, spyware and computer hacking and remove malicious code. Our graphic product enable customers to create 2D and 3D images. Our line of consumer products is available through direct sales on our website, indirect sales on partner websites and through traditional retail outlets.

### **Marketing & Sales Distribution Strategy**

Today's communication technologies are in a constant state of evolution, where ever more advanced devices, chips and networking platforms promise ever greater speed and capacity. Yet, for all the advances, it is the software that empowers the world of mobile convergence and makes these next-generation platforms accessible to the user. The opportunity before us now is to draw together the technologies under development across each of our business units into converged solutions the market now demands. We believe this is at the forefront of our innovation.

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We intend to continue to develop innovative, enabling technology and infrastructure products that facilitate the usage of wireless data and other premium mobile services, thereby providing our customers with additional revenue opportunities and differentiated services that encourage customer loyalty.

A core strategy is our ability to enable our customer to introduce new products to their markets that generate revenue; our ability to assist our wireless carrier and device manufacturer customers to reach a new market quickly is a value asset to our business model. Our industry knowledge and our research are used to determine the next market opportunities for our customers in the mobile market.

The Company utilizes a variety of direct and indirect sales distribution channels. We believe that sales of our differentiated product lines are enhanced by knowledgeable sales persons who can convey the value of the software.

The Company's Sales organizations are focused on expanding sales efforts in Europe, South America, Australia and Asia with dedicated sales coverage that is focused on deriving customer value. These sales teams deliver value by understanding their client's businesses and needs, bringing together new mobile product that allow our customers and potential customers to enter new market opportunities as demand for these innovative services emerges.

Smith Micro focuses on bringing together its lines of technology assets, investing in new software products for the wireless market.

*Leverage OEM Relationships.* We intend to continue to capitalize on our strong relationships with the world's leading wireless carriers and mobile device manufacturers. For example, our carrier customers serve as a valuable distribution channel, providing access to millions of end-users and also providing market feedback for future product offerings.

*Focus on Multiple High-Growth Markets.* We plan to continue to focus on the wireless communications, multimedia and enterprise FOTA markets and believe we are well-positioned to capitalize on the favorable trends in mobility services. Among these trends are the ongoing introduction of new data services by wireless carriers, the increasing availability of multimedia-enabled mobile devices and the need for consumers and enterprises to manage their wireless access to the Internet.

*Expand our Customer Base.* In addition to introducing new products to our customer, we intend to grow our domestic and international business through cross-selling our portfolio of products to our current customer base.

*Selectively Pursue Acquisitions of Complementary Products and Services.* In line with the company's strategy we plan to continue to pursue selected acquisition opportunities in an effort to expand our product and technological abilities, enter complementary markets and extend our geographic reach. In the past, we have used acquisitions to enhance our technology features and customer base, and to extend our offerings into new markets.

Smith Micro is expanding its ability to serve wireless carriers, OEMs and enterprise customers in Europe and Asia through international sales and support offices based in Sweden and Singapore respectively.

Our OEM market continues to evolve as we continue to offer new communications, content and image management products and OEM's adopt new technologies and software bundling techniques. These manufacturers bundle our software products with their own products. We have translated selected products into as many as eighteen languages to allow our OEM customers the flexibility of offering multi-language products that meet the needs of their worldwide markets.

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Our three largest OEM customers (Verizon Wireless, UTStarcom, and Sprint in 2007, Verizon Wireless, Kyocera Wireless and Alltel in 2006 and 2005), and their respective affiliates, in each year, have accounted for 68.5% of our net revenues in 2007, 77.4% of our net revenue in 2006 and 63.5 % of our net revenue in 2005. Our major customers could reduce their orders of our products in favor of a competitor's product or for any other reason. The loss of any of our major OEM customers or decisions by a significant OEM customer to substantially reduce purchases could have a material adverse effect on our business. Sales to Verizon Wireless amounted to approximately 64.4%, 74.4%, and 57.1% of the Company's net revenues for 2007, 2006 and 2005, respectively.

**Integration Initiatives**

Smith Micro is committed to its transformation to integrate recent acquisition for engineering, sales and marketing within the Company. The Company continues to drive greater productivity, flexibility and cost savings by transforming and integrating its own business processes and function, including eliminating redundancies.

**Customer Service and Technical Support**

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

**Product Development**

The software industry, particularly the wireless market, is characterized by rapid and frequent changes in technology and user needs. We work closely with industry groups and customers, both current and potential, to help us anticipate changes in technology and determine future customer needs. Software functionality depends upon the capabilities of the hardware. Accordingly, we maintain engineering relationships with various hardware manufacturers and we develop our software in tandem with their 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 \$14.8 million, \$7.9 million and \$4.0 million for the years ended December 2007, 2006 and 2005, respectively.

**Manufacturing**

Our software is sold in several forms. We offer a package or kit that may include: CD-ROM(s); a cable; and certain other documentation or marketing material. We also permit selected OEM customers to duplicate our products on their own CD-ROM's and pay a royalty based on usage. The majority of our OEM business requires that we provide a CD, which includes a soft copy of a user guide. In other cases, we provide a complete data connectivity kit that includes a CD, manual and cable. Finally, we grant licenses to certain OEM customers that enable those customers to preload a copy of our software onto a personal computer. With the enterprise sales program, we offer site licenses under which a corporate user is allowed to distribute copies of the software to users within the corporate sites.

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

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**Competition**

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

We believe that the principal competitive factors affecting the mobile software market include: product features, ease of use, customization to customer-specific needs, product quality, price, customer service and effective sales and marketing efforts. Although we believe that our products currently compete favorably with respect to these factors, there can be no assurance that we can maintain our competitive position against current and potential competitors. We believe that the market for our software products has been and will continue to be characterized by significant price competition. A material reduction in the price of our products could negatively affect our profitability. We face competition from Microsoft due to its market dominance and the fact that it is the publisher of the most prevalent personal computer operating system, Windows.

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

**Proprietary Rights and Licenses**

Our success and ability to compete is dependent upon our software code base, our programming methodologies and other intellectual properties. To protect our proprietary technology, we rely on a combination of trade secrets, nondisclosure and patent, copyright and trademark law that may afford only limited protection. As of December 31, 2007, we own nine currently effective U.S. patents and 16 patent applications are currently pending. These patents provide generalized protection to our intellectual property base, and we will continue to apply for various patents and trademarks in the future.

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

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

**Table of Contents****Employees**

As of December 31, 2007, we had a total of 225 employees within the following departments: 103 in engineering; 73 in sales and marketing; 28 in management and administration; 12 in manufacturing and nine in customer support. We utilize temporary labor to assist during peak periods of manufacturing volume. We believe that our future success will depend in large part upon our continuing ability to attract and retain highly skilled managerial, sales, marketing, customer support, research and development personnel and consulting staff. Like other software companies, we face intense competition for such personnel, and we have at times experienced and continue to experience difficulty in recruiting qualified personnel. There can be no assurance that we will be successful in attracting, assimilating and retaining other qualified personnel in the future. We are not subject to any collective bargaining agreement and we believe that our relationships with our employees are good.

**Item 1A. RISK FACTORS**

*Our future operating results are highly uncertain. Before deciding to invest in our common stock or to maintain or increase 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 reports on Forms 10-K, 10-Q and 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, that could seriously harm our business, financial condition or results of operations. In that event, the market price for our common stock could decline and you may lose all or part of your investment.*

***We depend upon a single customer for a significant portion of our total net revenues.***

Our largest customer, Verizon Wireless, accounted for 64.4% and 74.4% of our net revenues in the years ended December 31, 2007 and 2006, respectively. In the past, we have derived a substantial portion of our revenues from sales to a small number of customers, including Verizon Wireless, and expect to continue to do so in the future. This concentration may increase in future quarters, particularly if our relationship with one major customer makes it more difficult to sell to its competitors. In that event, our revenue growth opportunities may be limited. The agreements we have with these customers are no-exclusive and do not require them to purchase any minimum quantity of our products and may be terminated by the customer or us at any time for any reason upon minimal prior written notice. These customers may not continue to place large orders for our products in the future, or purchase our products at all. If these customers fail to purchase our products at current levels, terminate or decide not to renew their agreements with us, or if the terms of our future agreements with them are less favorable to us, our revenues could decline.

Our customers may acquire products from our competitors or develop their own products that compete directly with ours. In addition, our customers may adopt new and emerging technologies that we are unable to serve effectively or that are served by more established competitors. Any substantial decrease or delay in our sales to one or more of these customers, particularly Verizon Wireless, in any quarter would have a material adverse effect on our results of operations. In addition, certain of our customers have in the past and may in the future acquire competitors in their industry or be acquired by competitors in their industry, causing further industry consolidation. In the past, such acquisitions have caused the purchasing departments of the combined companies to reevaluate their purchasing decisions. If one of our major customers engages in an acquisition transaction in the future, the resulting entity could change its current purchasing habits. As a result, we could lose the customer, or experience a decrease in orders from or profit margins related to that customer or a delay in orders previously made by that customer. Further, although we maintain allowances for doubtful accounts, the insolvency of one or more of our major customers could result in a substantial decrease in our revenues.



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***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 revenue 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;

the size and timing of any return product requests for our products;

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 have involved, and we expect will continue to 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 would reduce our revenues, which would adversely affect our quarterly financial performance. Also, we have often booked 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.

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.

***Our total net revenues currently depend on a small number of products, so our operating results are vulnerable to unexpected shifts in demand.***

Substantially all of our total net revenue in recent years was derived from sales of our wireless connectivity software products until the third quarter of 2005, when we began including sales of products acquired in the Allume

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Systems, Inc. acquisition. In addition, during 2006, a substantial portion of our total revenue has been derived from sales of our music management software, particularly sales of V CAST Music Essentials Kit for Verizon Wireless. Although we have introduced new products in recent quarters and our strategy is to continue to introduce new products, these efforts may not reduce the extent to which our total revenues are dependent on one or more of our products in future periods.

We also derive a significant portion of our revenues from a few vertical markets. In particular, our music management software products are primarily sold to wireless carriers. In order to sustain and grow our business, we must continue to sell our software products into these vertical markets. Shifts in the dynamics of these vertical markets, such as new product introductions by our competitors, could seriously harm our results of operations, financial condition and prospects.

To increase our sales outside our core vertical markets, for example to large enterprises, requires 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, 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. Specifically, Microsoft Corporation poses a significant competitive threat to us because Microsoft operating systems may include some capabilities now provided by certain of our OEM and retail software products. If users are satisfied relying on the capabilities of the Windows-based systems or other operating systems, or other vendors products, sales of our products are likely to decline. In addition, 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 from both established and emerging software companies in the future. 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. Furthermore, our existing and potential OEM customers may acquire or develop products that compete directly with our products.

Microsoft and 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 us 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 large competitors such as Microsoft or other vendors could result in the cancellation of orders by customers in anticipation of the introduction of such new products. In addition, some of our competitors currently make 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.

***Acquisitions of companies or technologies may disrupt our business and divert management attention and cause our current operations to suffer.***

In 2007, we acquired Ecutel Systems, Inc. and the assets of Insignia Solutions, plc and eFrontier America, Inc., and in January 2008, we completed the acquisition of the Mobility Solutions Group of PCTEL. As part of 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 businesses. We may not be able to maintain uniform standards, controls, procedures and policies if we fail in these efforts. Similarly, 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 current 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.



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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 acquisitions.

***We have recently entered new, emerging markets in which we have limited experience; if these markets do not develop or we are unable to otherwise succeed in them, our revenues will suffer and the price of our common stock will likely decline.***

Our recent product introductions, such as StuffIt Wireless, a technology for file compression, Active Images, an image-enhancement platform designed for portable devices, and the technology that underlies our firmware-over-the-air (FOTA) products have allowed us to enter new markets. We have a short operating history in these emerging markets and limited experience with image and FOTA software and platforms. A viable market for these products may not develop or be sustainable, and we may face intense competition in these markets. In addition, our success in these markets depends on our carrier customers' ability to successfully introduce new mobile services enabled by our products and our ability to broaden our carrier customer base, which we believe will be difficult and time-consuming. If the expected benefits from entering new markets do not materialize, our revenues will suffer and the price of our common stock would likely decline. In addition, to the extent we enter new markets through acquisitions of companies or technologies, our financial condition could be harmed or our stockholders could suffer dilution without a corresponding benefit to our company if we do not realize expected benefits of entering such new markets.

***If the adoption of and investments in new technologies and services grows more slowly than anticipated in our product planning and development, our operating results, financial condition and prospects may be negatively affected.***

If the adoption of and investments in new technologies and services does not grow or grows more slowly than anticipated, we will not obtain the anticipated returns from our planning and development investments. For example, our new QuickLink Mobile and QuickLink Enterprise products incorporate mobile IP technology which allow notebook users the ability to roam between wireless wide area networks and Wi-Fi hot spots, and to seamlessly hand off to the enterprise LAN without losing connectivity. In addition, our new FOTA products allow our customers to update mobile devices from a home office; technology that provides a mechanism to allow for efficient firmware updates for mobile devices. Future sales and any future profits from these and related products are substantially dependent upon the acceptance and use of Wi-Fi, and on the continued adoption of mobile device services.

Many of our customers and other communications service providers have made and continue to make major investments in next generation networks that are intended to support more complex applications. If communications service providers delay their deployment of networks or fail to deploy such networks successfully, demand for our products could decline, which would adversely affect our revenues. Also, to the extent we devote substantial resources and incur significant expenses to enable our products to be interoperable with new networks that have failed or have been delayed or not deployed, our operating results, financial condition and prospects may be negatively affected.

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

We sell our products for use on handheld devices primarily through our carrier customers. Losing the support of these customers may limit our ability to compete in existing and potential markets and could negatively affect our revenues. In addition, the success of these customers and their ability and willingness to market services supported by our products are critical to our future success. Our ability to generate revenues from sales of our software, including from Verizon Wireless's use of our software in its music and multi-media efforts, 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 carrier customers, particularly our largest customer, Verizon Wireless, 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.

***Our gross margins may continue to change due to shifts in our sales mix.***

Gross margins associated with revenues from our data and music kits are significantly lower than gross margins associated with revenues from sales of our software. This is primarily due to the fact that such kits contain hardware that must be purchased from third parties. As we had introduced music kits in our fourth quarter of 2006 and the volume of kits have changed quarter to quarter, our overall gross margins can change and have ranged from 79.7% in 2005 to 62.8% in 2006 to 71.9% in 2007. Our future gross margin could fluctuate based on the mix of products sold in a quarter.

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

Our software products are complex and may contain undetected defects. In the past, we have discovered software defects in certain of our products and have experienced delayed or lost revenues during the period it took to correct these problems. Although we and our OEM customers test our products, it is possible that errors may be found or occur in our new or existing products after we have commenced commercial shipment of those products. Defects, whether actual or perceived, could result in adverse publicity, loss of revenues, product returns, 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.

***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, keep up with evolving industry standards, including changes in the Microsoft operating systems with which our products are designed to be compatible, and to promote those products successfully. The communications and utilities 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. Any of these factors could render our existing products obsolete and unmarketable. 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. 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.

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***Delays or failure in deliveries from our third-party suppliers could cause our net revenue to decline and harm our results of operations.***

We rely on third party suppliers to provide us with services and components for our product kits. These components include: compact discs; cables; printed manuals; and boxes. We do not have long-term supply arrangements with any vendor to obtain these necessary services and components for our products. If we are unable to purchase components from these suppliers or if the compact disc replication services that we use do not deliver our requirements on schedule, we may not be able to deliver products to our customers on a timely basis or enter into new orders because of a shortage in components. Any delays that we experience in delivering our products to customers could impair our customer relationships and adversely impact our reputation and our business. In addition, if our third party suppliers raise their prices for components or services, our gross margins would be reduced.

***A shortage in the supply of wireless communication devices such as PC cards could adversely affect our revenues.***

Our products are utilized with major wireless networks throughout the world that support data communications through the use of wireless communication devices such as PC cards. Because wireless network providers generally incorporate our products into the wireless communication devices that they sell directly to individual consumers, our future success depends upon the availability of such devices to consumers at reasonable prices. A shortage in the supply of wireless communication devices could put upward pressure on prices or limit the quantities available to individual consumers which could materially affect the revenues that we generate from our products.

***If our products are not designed into customer products, our products may not be adopted by our target markets and customers, either of which could negatively impact our results of operations.***

Some of our products must be incorporated into our customers' products at the design stage. As a result, we rely on OEM customers to select our products to be designed into their products. We may devote significant resources and incur significant expense on the development of a new product without any assurance that an OEM customer will select our product for design into its own product. Once an OEM customer designs a competitor's product into its product offering, it becomes significantly more difficult for us to sell our products to that customer because changing vendors involves significant cost, time, effort and risk for the customer. In addition, such design decisions are typically only made when a new system configuration is introduced, which may occur infrequently. Our development expenses may never be recovered and our results of operations and financial condition will be seriously harmed if our products are not selected at the design stage. Even if our products are selected at the design stage, sales of such products are outside of our control and we may never earn material revenues from such product sales.

***Regulations affecting our customers and us and future regulations to which they or we may become subject 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 United States 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.

**Table of Contents*****We may be unable to adequately protect our intellectual property and other proprietary rights, which could negatively impact our revenues.***

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 secret, nondisclosure and copyright and trademark law. We currently own United States trademark registrations for certain of our trademarks and United States 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.

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 fax 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.

***Our ability to predict our quarterly revenues and operating results is extremely limited.***

We have historically operated with little backlog because we have generally shipped our software products and recognized revenue shortly after we received orders because our production cycle has traditionally been very short. As a result, our sales in any quarter were generally dependent on orders that were booked and shipped in that quarter. As our wireless business has evolved, production cycle time for items such as data kits has increased to the point that orders received toward the end of a quarter may not ship until the subsequent quarter. From time to time, customers may issue purchase orders that have extended delivery dates that may cause the shipment to be deferred to a subsequent quarter. These situations make it difficult for us to predict what our revenues and operating results will be in any quarter. Therefore, our level of backlog is not necessarily indicative of trends in our business.

***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 and consulting personnel. We do not have employment agreements with our key employees that govern the length of their service. 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.



**Table of Contents*****If we fail to continue to establish and maintain strategic relationships with mobile device manufacturers, market acceptance of our products, and our profitability, may suffer.***

Most of our strategic relationships with mobile device manufacturers are not subject to written contract, but rather are in the form of informal working relationships. We believe these relationships are valuable to our success. In particular, these relationships provide us with insights into product development and emerging technologies, which allows us to keep abreast of, or anticipate, market trends and helps us serve our current and prospective customers. Because these relationships are not typically governed by written agreements, there is no obligation for many of our partners to continue working with us. If we are unable to maintain our existing strategic relationships with mobile device manufacturers or if we fail to enter into additional strategic relationships or the parties with whom we have strategic relationships 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 could choose a competitor's software over ours or develop their own. Even if we succeed in establishing these relationships, they may not result in additional customers or revenues.

***Certain individuals to whom we have granted stock options may have a right of rescission as to the options.***

Approximately 4,539,500 stock options having a weighted average exercise price of \$3.74 that were granted under our 1995 Stock Option / Stock Issuance Plan and 2005 Stock Option / Stock Issuance Plan between August 5, 2002 and August 31, 2006 were not exempt from registration or qualification under the securities laws of certain states, nor were they registered or qualified in such states. As a result, holders of these stock options, subject to the securities laws of the state in which they live, have a right of rescission with respect to the options. This means that if a holder elects to exercise his or her right of rescission, he or she will have a right to require us to repurchase the option for cash. Rescission rights or similar remedies may be available to persons who were granted options and no longer hold them. No liability has been recorded for these rescission rights or remedies. In addition, we may be subject to fines, penalties or enforcement actions by applicable state regulatory agencies regarding these issuances.

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

We believe that the cash, cash equivalents and investments on hand and the cash we expect to generate from operations will be sufficient to meet our capital needs for at least the next twelve months. However, it is possible that we may need or choose to obtain additional financing to fund our activities in the future. 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. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of the holders of our common stock. We currently have no established line of credit or other business borrowing facility in place.

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It is possible that our future capital requirements may vary materially from those now planned. The amount of capital that we will need in the future will depend on many factors, including:

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 inventory and accounts receivable 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, infrastructure and facility needs or to consummate acquisitions of other businesses, products or technologies.

***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 United States 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;

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.

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**Item 1B. UNRESOLVED STAFF COMMENTS**

None.

**Item 2. PROPERTIES**

Our corporate headquarters, including our principal administrative, sales and marketing, customer support and research and development facility, is located in Aliso Viejo, California, where we currently lease and occupy approximately 33,000 square feet of space pursuant to leases that expires May 31, 2016.

We also lease approximately 13,600 square feet in Watsonville, California under leases that expires September 30, 2010, approximately 3,700 square feet of space in Herndon, Virginia under a sublease that expires August 31, 2009, and approximately 3,400 square feet in Campbell, California under a lease that expires January 31, 2009. We occupy office space in Stockholm, Sweden, Oslo, Norway and Seoul, South Korea for 1 year terms expiring in August 2008 and in Lees Summit, Missouri on a month to month basis.

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

**Item 3. LEGAL PROCEEDINGS**

The Company is not involved in any pending material legal proceedings at this time although we may become subject to legal proceedings or claims that arise in the ordinary course of business or otherwise.

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

A Special Meeting of the Stockholders of the Company was held on September 28, 2007. This meeting was adjourned, and reconvened on October 11, 2007. At the reconvened Special Meeting, the Stockholders voted to approve an amendment to the 2005 Stock Option / Stock Issuance plan to increase the maximum number of shares of common stock that may be issued under the 2005 Plan from 5,000,000 shares (plus an annual increase) to 7,000,000 shares (plus an annual increase). A total of 8,826,033 shares were voted for the proposal, 8,580,388 shares were voted against and 139,595 abstained from voting on the matter.

**Table of Contents****PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASERS OF EQUITY SECURITIES****Market Information**

Our common stock is traded on the Nasdaq Global 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, 2007: |         |       |
| First Quarter                 | \$20.04 | 12.13 |
| Second Quarter                | 21.20   | 11.91 |
| Third Quarter                 | 18.60   | 13.27 |
| Fourth Quarter                | 16.95   | 7.32  |
| YEAR ENDED DECEMBER 31, 2006: |         |       |
| First Quarter                 | 12.65   | 5.87  |
| Second Quarter                | 16.50   | 10.85 |
| Third Quarter                 | 16.70   | 9.01  |
| Fourth Quarter                | 19.01   | 13.35 |

On March 6, 2008, the closing sale price for our common stock as reported by Nasdaq was \$6.57.

**Stock Performance Graph**

The following graph and information compares the cumulative total stockholder return on our Common Stock against the cumulative total return of the S&P Midcap 400 Index and the S&P Midcap Applications Software Index (Peer Group) for the same period.

The graph covers the period from January 1, 2001, through December 31, 2006. The graph assumes that \$100 was invested in our Common Stock on January 1, 2001, and in each index, and that all dividends were reinvested. No cash dividends have been declared on our Common Stock. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.

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|   | <b>12/02</b>  | <b>12/03</b>  | <b>12/04</b>   | <b>12/05</b>   | <b>12/06</b>   | <b>12/07</b>   |
|---|---------------|---------------|----------------|----------------|----------------|----------------|
| <b>Smith Micro Software,<br/>Inc.</b>                                     | <b>100.00</b> | <b>432.61</b> | <b>1945.65</b> | <b>3084.78</b> | <b>1841.30</b> | <b>1351.43</b> |
| <b>S &amp; P Midcap 400<br/>S &amp; P Midcap<br/>Software Application</b> | <b>100.00</b> | <b>135.62</b> | <b>157.97</b>  | <b>177.81</b>  | <b>196.16</b>  | <b>211.81</b>  |
|   | <b>100.00</b> | <b>150.38</b> | <b>128.96</b>  | <b>143.18</b>  | <b>164.59</b>  | <b>154.35</b>  |

 **Holders**

As of March 6, 2008, there were approximately 112 holders of record of our common stock based on information provided by our transfer agent.

 **Dividends**

We have never paid any cash dividends on our common stock and we have no current plans to do so.

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**Recent Sales of Unregistered Securities**

None

**Purchases of Equity Securities by the Company**

None.

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**Table of Contents****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 Annual Report. The following selected consolidated statement of operations data for the years ended December 31, 2007, 2006 and 2005, and the consolidated balance sheet data at December 31, 2007 and 2006, have been derived from audited consolidated financial statements included elsewhere in this Annual Report. The consolidated statement of operations data presented below for the years ended December 31, 2004 and 2003, and the consolidated balance sheet data at December 31, 2005, 2004 and 2003 are derived from audited consolidated financial statements that are not included in this Annual Report.

|   | <b>Year Ended December 31,</b> |             |             |             |             |
|---|--------------------------------|-------------|-------------|-------------|-------------|
|   | <b>2007</b>                    | <b>2006</b> | <b>2005</b> | <b>2004</b> | <b>2003</b> |
| <b>Consolidated Statement of Operations</b> |                                |             |             |             |             |
| <b>Data:</b>                                |                                |             |             |             |             |
| Net Revenues                                | \$ 73,377                      | \$ 54,469   | \$ 20,258   | \$ 13,316   | \$ 7,216    |
| Cost of Revenues                            | 20,644                         | 20,259      | 4,103       | 2,910       | 1,671       |
| Gross profit                                | 52,733                         | 34,210      | 16,155      | 10,406      | 5,545       |
| Operating expenses:                         |                                |             |             |             |             |
| Selling and marketing                       | 18,394                         | 9,057       | 3,410       | 1,519       | 1,666       |
| Research and development                    | 14,772                         | 7,899       | 3,963       | 2,556       | 2,506       |
| General and administrative                  | 15,318                         | 8,467       | 4,621       | 2,868       | 2,330       |
| Total operating expenses                    | 48,484                         | 25,423      | 11,994      | 6,943       | 6,502       |
| Operating income (loss)                     | 4,249                          | 8,787       | 4,161       | 3,463       | (957)       |
| Interest Income                             | 4,254                          | 1,403       | 667         | 53          | 37          |
| Income (Loss) before income taxes           | 8,503                          | 10,190      | 4,828       | 3,516       | (920)       |
| Income tax expense (benefit)                | 5,342                          | 1,234       | 104         | 71          | 3           |
| Net Income (Loss)                           | \$ 3,161                       | \$ 8,956    | \$ 4,724    | \$ 3,445    | \$ (923)    |
| Net income (loss) per share, basic          | \$ 0.11                        | \$ 0.38     | \$ 0.22     | \$ 0.20     | \$ (0.06)   |
| Weighted average shares, basic              | 29,768                         | 23,753      | 21,351      | 17,267      | 16,511      |
| Net income (loss) per share, diluted        | \$ 0.10                        | \$ 0.35     | \$ 0.21     | \$ 0.19     | \$ (0.06)   |
| Weighted average shares, diluted            | 30,998                         | 25,330      | 22,806      | 18,412      | 16,511      |
|   | <b>As of December 31,</b>      |             |             |             |             |
|   | <b>2007</b>                    | <b>2006</b> | <b>2005</b> | <b>2004</b> | <b>2003</b> |



**Consolidated Balance Sheet**

**Data:**

|                                |            |            |           |           |          |
|--------------------------------|------------|------------|-----------|-----------|----------|
| Total assets                   | \$ 162,421 | \$ 131,026 | \$ 42,716 | \$ 12,828 | \$ 6,587 |
| Total liabilities              | 7,907      | 4,969      | 3,759     | 1,729     | 997      |
| Accumulated earnings (deficit) | 172        | (2,989)    | (11,945)  | (16,669)  | (20,114) |
| Total stockholders' equity     | \$ 154,514 | \$ 126,057 | \$ 38,957 | \$ 11,099 | \$ 5,590 |

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**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 Annual Report. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation the disclosures made in Item 1A of Part I of this Annual Report under the caption Risk Factors.*

*Risk factors that could cause actual results to differ from those contained in the forward-looking statements including but are not limited to: our dependence upon a single customer for a significant portion of our revenues; potential fluctuations in quarterly results; deriving revenues from a small number of products; failure to successfully compete; failure to successfully integrate acquisitions; entry into new markets; failure of our customers to adopt new technologies; dependence upon relationships with carrier customers; declines in gross margins; undetected software defects; changes in technology; delays or failure in deliveries from component suppliers; failure of our products to achieve broad acceptance; failure to protect intellectual property; exposure to intellectual property claims; and loss of key personnel.*

**Introduction and Overview**

Our business model is based primarily upon the design, production and sale of software that supports the wireless industry. Our products are utilized in major wireless networks throughout the world that support data communications through the use of mobile devices or other wireless communication devices such as PC cards, USB modems, and embedded modems. Wireless network providers generally incorporate our products into their accessory products sold directly to individual consumers or on servers in the network environment to facilitate firmware over-the-air updating for mobile devices.

Our business is primarily dependent upon the demand for wireless communications and content management solutions and the corresponding requirements for software solutions to support this demand. During the last three years, demand for these types of products has increased as wireless providers race to introduce higher network speeds, and launch new services that utilize these improving wireless broadband networks.

We continue to invest in research and development for one of the industry's leading wireless product lines and we believe we are uniquely positioned to capitalize on market opportunities as we leverage the strength of our technology capabilities with our growing global reach and expanding product lines. .

During 2007, we were focused on integrating three major acquisitions while organically growing our business. As such, we saw a significant increase in revenues accompanied by an increase in operating expenses, including significant non-cash expenses which include stock based compensation, amortization of intangibles associated with acquisitions, and non cash tax expense. We believe that there continues to be excellent growth opportunities within the wireless communications software marketplace and we continue to focus on positioning Smith Micro to benefit from these opportunities.

**Table of Contents****Results of Operations**

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

|                            | <b>Years Ended December 31,</b> |             |             |
|----------------------------|---------------------------------|-------------|-------------|
|                            | <b>2007</b>                     | <b>2006</b> | <b>2005</b> |
| Net revenues               | 100.0%                          | 100.0%      | 100.0%      |
| Cost of revenues           | 28.1%                           | 37.2%       | 20.3%       |
| Gross profit               | 71.9%                           | 62.8%       | 79.7%       |
| Operating expenses:        |                                 |             |             |
| Selling and marketing      | 25.1%                           | 16.6%       | 16.8%       |
| Research and development   | 20.1%                           | 14.5%       | 19.6%       |
| General and administrative | 20.9%                           | 15.6%       | 22.8%       |
| Total operating expenses   | 66.1%                           | 46.7%       | 59.2%       |
| Operating Income           | 5.8%                            | 16.1%       | 20.5%       |
| Interest Income            | 5.8%                            | 2.6%        | 3.3%        |
| Income before income taxes | 11.6%                           | 18.7%       | 23.8%       |
| Income tax expense         | 7.3%                            | 2.3%        | 0.5%        |
| Net Income                 | 4.3%                            | 16.4%       | 23.3%       |

**Revenues**

In the first four months of 2007, we completed two acquisitions. We acquired of Ecutel Systems, Inc. in February 2007, and the assets of Insignia Solutions in April 2007. In addition, we acquired certain assets from eFrontier in December 2007 and the Mobile Solutions Group of PCTEL in January 2008. Due to the new acquisitions and the broadening of our OEM product offering, we began to break out our 2007 revenues consistent with our new internal operating perspective.

We currently sell products in the following product categories: Multimedia, which includes music, photo and video library management; Connectivity and Security, which includes our connection manager solutions for both the OEM and enterprise channels; Consumer, which includes retail sales of our compression and broad consumer-based software; Mobile Device Solutions, which includes our firmware over the air upgrade software branded under the Insignia name, and other revenue, which includes the consulting portion of our services sector which has been de-emphasized and is no longer considered a strategic element of our go forward plan.

Total net revenues were \$73.4 million, \$54.5 million and \$20.3 million in 2007, 2006 and 2005, respectively, with an increase of \$18.9 million, or 34.7% from 2006 to 2007 and an increase of \$34.2 million, or 168.9% from 2005 to 2006. The increase in our revenues from 2005 through 2007 is attributed to the growth in sales of our wireless and consumer utility products. In late 2005 we entered the wireless music software space which was the largest selling product group for 2006 and largely responsible for the increase in revenues from 2005 to 2006. In 2007, we saw a significant increase in our Connectivity software which was a key driver to the 34.7% increase in sales over 2006. Sales to individual customers and their affiliates, which amounted to more than 10% of the Company's net revenues, included one OEM customer at 64.4% in 2007, 74.4% in 2006 and 57.1% of net revenues in 2005.

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The following table shows the net revenues and cost of revenues generated by each segment:

|                         | <b>Year Ended December 31,</b> |             |             |
|-------------------------|--------------------------------|-------------|-------------|
|                         | <b>2007</b>                    | <b>2006</b> | <b>2005</b> |
| Multimedia              | \$ 26,456                      | \$ 28,388   | \$ 1,278    |
| Connectivity & Security | 29,589                         | 14,613      | 12,406      |
| Consumer                | 14,368                         | 10,511      | 5,895       |
| Mobile Device Solutions | 1,774                          |             |             |
| Corporate/Other         | 1,190                          | 957         | 679         |
| Total Revenues          | 73,377                         | 54,469      | 20,258      |
| Cost of revenues        | 20,624                         | 20,259      | 4,103       |
| Gross Profit            | \$ 52,753                      | \$ 34,210   | \$ 16,155   |

Multimedia sales decreased \$1.9 million or 6.8% from 2006 to 2007. While the number of units of Music related software increased from 2006 to 2007, we saw a shift in how the product was merchandised by our primary music customer; in 2006 this product was sold primarily as a higher revenue, lower margin music kit (including software, cable and ear buds). In 2007, the music product was sold as a kit, a software download and as a software only CD, the later two options being lower revenue per unit, but much higher margin per unit.

Connectivity & Security sales increased \$15.0 million, or 102.5%, from 2006 to 2007 as a result of the continued success of the EVDO (a wireless Internet standard) rollout by our carrier customers and the introduction of Rev A- EVDO hardware in late 2006 which is currently being rolled out by our customers.

Consumer sales increased \$3.9 million, or 36.7%, from 2006 to 2007 primarily due to a new publishing deal with VMware, to market their Fusion product.

Mobile Device Solutions is a new revenue stream which came to us via the acquisition of assets from Insignia in April 2007.

Finally, Corporate/Other revenue was relatively flat over the three year period.

**Cost of Revenues and Gross Margin**

*Cost of Revenues.* Cost of revenues was \$20.6 million, \$20.3 million and \$4.1 million in 2007, 2006 and 2005, respectively, representing an increase of \$365,000, or 1.8% from 2006 to 2007 and an increase of \$16.2 million, or 393.8% from 2005 to 2006. Gross margin as a percentage of net revenue was 71.9% for 2007 as compared to 62.8% for 2006 and 79.8% for 2005. Cost of Revenues for 2007 includes \$1.6 million of amortization of intangibles associated with acquisitions as compared to \$1.1 million in 2006 and \$534,000 in 2005. In addition, there is \$295,000 and \$33,000 of stock compensation expense included in 2007 and 2006 which is not present in 2005. Factoring out these costs, gross margin was 74.4% in 2007, 64.9% in 2006 and 83.3% in 2005. The 54.5% increase in non-GAAP gross margin percentage from 2006 to 2007 is attributed to both the increase in sales of our high margin connectivity software and the shift in the way our music product is merchandized by our largest customer. In 2006, our music product was sold primarily as a music kit (discussed above), while in 2007, the product was sold as a kit, a software download and as a software CD. The non-GAAP decrease in gross margin percent from 2005 to 2006 is attributed to the rapid adoption of our lower margin music kit product by our largest customer.

Direct costs of revenues consist primarily of CD replication costs, and the cost of music kit components which include ear phones and a cable that connects the handheld device to the PC. We use a variety of providers located in China, Korea and the United States. We consider CD replication, ear phones and cables to be commodities with little or no risk to supplier fluctuations. We also purchase proprietary cables from Motorola and generic OEM cables from a

variety of suppliers.

**Table of Contents****Operating Expenses**

The following table presents a breakdown of our operating expenses by functional category and as a percentage of total net revenues:

|                            | Years Ended December 31, |       |          |       |          |       |
|----------------------------|--------------------------|-------|----------|-------|----------|-------|
|                            | 2007                     |       | 2006     |       | 2005     |       |
| Operating expenses:        |                          |       |          |       |          |       |
| Selling and marketing      | \$ 18,394                | 25.1% | \$ 9,057 | 16.6% | \$ 3,410 | 16.8% |
| Research and development   | 14,772                   | 20.1% | 7,899    | 14.5% | 3,963    | 19.6% |
| General and administrative | 15,318                   | 20.9% | 8,467    | 15.6% | 4,621    | 22.8% |
| Total operating expenses   | \$48,484                 | 66.1% | \$25,423 | 46.7% | \$11,994 | 59.2% |

*Selling and Marketing.* Selling and marketing expenses were \$18.4 million, \$9.1 million and \$3.4 million in 2007, 2006 and 2005, respectively, representing an increase of \$9.3 million, or 103.1%, from 2006 to 2007 and an increase of \$5.6 million, or 165.6%, from 2005 to 2006. Our selling and marketing expenses consist primarily of personnel costs, advertising costs, sales commissions and trade show expenses. These expenses vary significantly from quarter to quarter based on the timing of trade shows and product introductions. While most of the increases in selling and marketing expenses were due to acquisitions, we also had an increase in headcount and increases in costs related to product collateral concept and design. Advertising expenses were \$540,000, \$379,000 and \$223,000 for the years ended December 31, 2007, 2006 and 2005, respectively. Selling and marketing expenses were 25.1%, 16.6% and 16.8% of revenues in the years ended December 31, 2007, 2006 and 2005, respectively. Selling and marketing expenses include \$673,000 of amortization expense related to acquisitions for 2007, \$483,000 for 2006 and \$236,000 for 2005. In addition, 2007 and 2006 selling and marketing expenses include \$5.8 million and \$2.1 million, respectively, of stock based compensation expense, not included in 2005. Factoring out amortization and stock based compensation costs, selling and marketing expenses were 16.3% of revenues in 2007 and 11.9% of revenues in 2006.

*Research and Development.* Research and development expenses were \$14.8 million, \$7.9 million and \$4.0 million in 2007, 2006 and 2005, respectively, representing increases of \$6.9 million, or 87.0% from 2006 to 2007 and \$3.9 million, or 99.3% from 2005 to 2006. Our research and development expenses consist primarily of personnel and equipment costs required to conduct our software development efforts. We remain focused on the development and expansion of our technology, particularly our wireless, multi-media, and compression software technologies. The increase in our research and development expenses in each year was related to the development of new wireless products that were released during the periods, with an accompanying increase in headcount and a refocus of engineering resources from consulting projects to new product development. Beginning in 2005, the key driver to increased R&D expense was the addition of engineering personnel associated with the acquisition of Allume Systems on July 1, 2005, PhoTags, Inc. on April 3, 2006, Ecutel Systems, Inc. in February 2007 and the assets of Insignia Solutions, plc in April 2007. Research and development expenses were 20.1%, 14.5% and 19.6% of revenues in the years ended December 31, 2007, 2006 and 2005, respectively. Research and development expenses include \$633,000 of amortization expense related to acquisitions in 2007, \$0 in 2006, and \$0 in 2005. In 2007 and 2006, research and development expenses include \$2.6 million and \$1.1 million, respectively, of stock based compensation. Factoring out amortization and stock compensation expenses, research and development expenses were 15.8% and 12.5% of net revenues in 2007 and 2006, respectively.

*General and Administrative.* General and administrative expenses were \$15.3 million, \$8.5 million and \$4.6 million in 2007, 2006 and 2005, respectively, representing increases of \$6.9 million, or 80.9% from 2006 to 2007 and \$3.8 million, or 83.2% from 2005 to 2006. The increases in general and administrative expenses are primarily

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due to acquisitions throughout the period and the assumption of related G&A staff and certain integration costs. In addition, general and administrative expenses in both 2007 and 2006 included the costs of compliance with Sarbanes-Oxley. General and administrative expenses were 20.9%, 15.5% and 22.8% of net revenues in the years ended December 31, 2007, 2006 and 2005, respectively. In 2007 and 2006, general and administrative expenses include \$6.0 million and \$2.3 million, respectively, of stock based compensation expenses. Also included in 2006 G&A expense was the write off of goodwill related to our Services segment. Factoring out non-cash expenses, general and administrative expenses were 12.7% and 10.8% of net revenues in 2007 and 2006, respectively. The decrease in general and administrative expenses as a percentage of revenues from 2005 to 2006 is due to the significant increase in revenues during the period, while the increase from 2006 to 2007 can be attributed to the increased costs of compliance with Sarbanes Oxley legislation.

*Interest Income.* Interest income was \$4.3 million, \$1.4 million and \$667,000 in 2007, 2006 and 2005, respectively, representing increases of \$2.8 million, or 203.2% from 2006 to 2007 and \$736,000, or 110.3% from 2005 to 2006. Interest income is directly related to our cash balances throughout the period and varies among periods. On December 14, 2006, we closed a fully marketed secondary offering, resulting in the issuance of 4 million shares with net cash proceeds to the company of \$55.0 million in 2006. On January 18, 2007 an additional 387,000 shares were sold under the same agreement, resulting in additional net proceeds of \$5.3 million. We have not changed our investment strategy during the periods being reported, with our excess cash consistently being invested in short term marketable securities. (See *Liquidity and Capital Resources* for further discussion elsewhere in this report.)

*Provision for Income Taxes.* The provision for income taxes was \$5.3 million, \$1.2 million and \$104,000 in 2007, 2006 and 2005, respectively. In the 2005 period, our tax provision was fully reserved, and the tax expense for that period was primarily a provision for alternative minimum taxes and certain state minimum tax payments. In the fourth quarter of 2006, we released our reserve on our tax provision which resulted in favorable tax expense for the period. In 2007, our tax expense reflects our tax provision and is largely non-cash based, unfavorably affected by FAS123-R stock compensation expenses. We began 2007 with a net loss carryforward of approximately \$15 million Federal and \$12 million State, and ended the year with with net loss carryforwards of \$11.8 million Federal and \$6.9 million State.

**Liquidity and Capital Resources**

Since inception, we have financed our operations primarily through cash generated from operations and from net proceeds of \$18.1 million generated by our initial public offering in 1995. On February 18, 2005, we entered into a Common Stock Purchase Agreement for the private placement of 3,500,000 shares of our common stock, \$0.001 par value, at a price of \$6.40 per share, resulting in aggregate gross cash proceeds to the Company of \$22,400,000 before deducting commissions and other expenses. Offering costs related to the transaction totaled \$1,613,000, comprised of \$1,344,000 in commissions and \$269,000 cash payments for legal and investment services, resulting in net proceeds to the Company of \$20,786,000. The transaction closed simultaneously with the execution of the Purchase Agreement on February 18, 2005. C.E. Unterberg, Towbin LLC, the placement agent for the transaction, received a cash fee equal to 6% of the aggregate gross proceeds of the Private Placement.

On December 14, 2006, we completed a public offering, issuing 4,000,000 shares of our common stock, at a purchase price of \$14.75 per share, resulting in aggregate gross cash proceeds to the Company of \$59,000,000 before deducting commissions and other expenses. Offering costs related to the transaction totaled \$4,002,000, comprised of \$3,304,000 in underwriting discounts and commissions and \$698,000 cash payments for legal and investment services, resulting in net proceeds to the Company of \$54,998,000.

On January 18, 2007, an additional 387,000 shares were sold in the overallotment option granted to the underwriters, resulting in additional gross proceeds of \$5,708,000 before deducting commissions and other expenses. Offering costs incurred in 2007 include underwriting discounts and commissions of \$320,000 and \$48,000 cash payments for legal and accounting services, resulting in additional net proceeds to the Company of \$5,341,000.

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Net cash provided by operations was \$16.3 million in 2007, \$9.9 million in 2006 and \$2.5 million in 2005. The primary source of operating cash in all periods was our net income adjusted for depreciation, amortization and non cash stock compensation, offset by the increase of accounts receivable and the excess tax benefit related to stock options.

Cash flows used in investing activities were \$34.2 million in 2007, \$2.6 million in 2006 and \$11.0 million in 2005. In 2007, cash was used to fund several acquisitions, including Insignia Solutions, plc for \$15.4 million, Ecutel Systems, Inc. for \$8.0 million, eFrontier for \$5.1 million and an additional payout for PhoTags, Inc. on \$3.5 million. Other technology was acquired for \$1.2 million and capital expenditures were \$1.0 million in 2007. In 2006, \$2.2 million was used for the acquisition of PhoTags, Inc. and \$362,000 for capital expenditures. In 2005, \$10.9 million was used for the acquisition of Allume Systems, Inc. and \$142,000 for capital expenditures. Our capital expenditures in all periods consist of the purchase of computers and other office equipment. In 2007, cash flows from investing activities also include the build-out of additional space in the corporate headquarters and space additions in other sites.

Net cash provided by financing activities was \$12.9 million in 2007, \$64.1 million in 2006 and \$21.2 million in 2005. Included in the amounts above was \$5.3 million received in 2007 and \$55.0 million received in 2006 from the sale of stock as previously discussed. In 2005, cash provided by financing activities includes \$20.8 million as related to the private placement previously discussed. We also received \$3.8 million in cash from the exercise of employee stock options in 2007 compared to \$4.2 million in 2006 and \$369,000 in 2005. Effective January 1, 2006, in accordance with SFAS 123(R), we include the excess tax benefits from the exercise of stock options as a financing activity rather than an operating activity in the Consolidated Statement of Cash Flows. Excess tax benefits were \$3.8 million in 2007 as compared to \$4.9 million in 2006.

At December 31, 2007, we had \$87.5 million in cash and cash equivalents and \$96.6 million of working capital. On January 4, 2008, we acquired the Mobile Solutions Group of PCTEL at a cost of \$59.7 million in cash. Other than the aforementioned acquisition, we have no significant capital commitments, and currently anticipate that capital expenditures will not vary significantly from recent periods. We believe that our existing cash, cash equivalent investment balances and cash flow from operations will be sufficient to finance our working capital and capital expenditure requirements through at least the next twelve months. We may require additional funds to support our working capital requirements or for other purposes and may seek to raise additional funds through public or private equity or debt financing or from other sources. If additional financing is needed, we cannot assure that such financing will be available to us at commercially reasonable terms or at all.

Our corporate headquarters, which includes our principal administrative, sales and marketing, customer support and research and development facility, is located in Aliso Viejo, California. We have leased this space through May 2016. We also lease space in Watsonville, California; Herndon, Virginia; Campbell, California; Stockholm, Sweden; Oslo, Norway and Seoul, South Korea. Our office in Lee's Summit, Missouri was closed at the end of February 2008.

As of December 31, 2007, we had no debt and no long term liabilities. The following table summarizes our contractual obligations as of December 31, 2007 (in thousands):

|                                 | Total           | Payments due by period |                 |                 | More than 5 years |
|---------------------------------|-----------------|------------------------|-----------------|-----------------|-------------------|
|                                 |                 | 1 year or less         | 1-3 years       | 3-5 years       |                   |
| <b>Contractual obligations:</b> |                 |                        |                 |                 |                   |
| Operating Lease Obligations     | \$ 6,542        | \$ 1,133               | \$ 1,640        | \$ 1,587        | \$ 2,182          |
| Employment Agreement            | 100             | 100                    |                 |                 |                   |
| Purchase Obligations            | 684             | 684                    |                 |                 |                   |
| <b>Total</b>                    | <b>\$ 7,326</b> | <b>\$ 1,917</b>        | <b>\$ 1,640</b> | <b>\$ 1,587</b> | <b>\$ 2,182</b>   |





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

**Critical Accounting Policies**

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

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

**Revenue Recognition** We currently report our net revenues under the following operating groups: Multimedia, Connectivity & Security, Consumer, Mobile Device Management and Other. Within each of these groups software revenue is recognized based on the customer and contract type. We recognize revenue in accordance with the Statement of Position ( SOP ) 97-2, *Software Revenue Recognition*, as amended, when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed and determinable, and collectibility is probable. We recognize revenues from sales of our software to OEM customers or end users as completed products are shipped and title passes; or from royalties generated as authorized customers duplicate our software, if the other requirements of SOP 97-2 are met. If the requirements of SOP 97-2 are not met at the date of shipment, revenue is not recognized until these elements are known or resolved. Returns from OEM customers are limited to defective goods or goods shipped in error. Historically, OEM customer returns have not exceeded the very nominal estimates and reserves. Management reviews available retail channel information and makes a determination of a return provision for sales made to distributors and retailers based on current channel inventory levels and historical return patterns. Certain sales to distributors or retailers are made on a consignment basis. Revenue for consignment sales are not recognized until sell through to the final customer is established. Within the Consumer group certain revenues are booked net of revenue sharing payments, pursuant to the consensus of EITF 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. We have a few multiple elements agreement for which we have contracted to provide a perpetual license for use of proprietary software, to provide non-recurring engineering, and in some cases to provide software maintenance (post contract support). For multiple element agreements, vendor specific objective evidence of fair value for all contract elements is reviewed and the timing of the individual element revenue streams is determined and recognized consistent with SOP 97-2. Sales directly to end-users are recognized upon delivery. End users have a thirty day right of return, but such returns are reasonably estimable and have historically been immaterial. We also provide technical support to our customers. Such costs have historically been insignificant.

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*Accounts Receivable* 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 a bad debt 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.

*Goodwill* We have adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, effective January 1, 2002 and no impairment was identified. As a result of the adoption, we are no longer required to amortize goodwill. Prior to the adoption of SFAS 142, goodwill was amortized over 7 years. In accordance with SFAS No. 142, 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. At December 31, 2006, we elected to write off all goodwill associated with our services sector, or \$335,000. The consulting portion of our services sector has been de-emphasized and is no longer considered a strategic element of our go forward plan. We determined that we did not have any impairment of goodwill as related to the products sector at December 31, 2006. Estimates of reporting unit fair value are based upon market capitalization and therefore are volatile being sensitive to market fluctuations. To the extent that our market capitalization decreases significantly or the allocation of value to our reporting units change, we could be required to write off some or all of our goodwill.

*Deferred Income Taxes* We account for income taxes under SFAS No. 109, *Accounting for Income Taxes*. This statement requires the recognition of deferred tax assets and liabilities for the future consequences of events that have been recognized in our financial statements or tax returns. The measurement of the deferred items is based on enacted tax laws. In the event the future consequences of differences between financial reporting bases and the tax bases of our assets and liabilities result in a deferred tax asset, SFAS No. 109 requires an evaluation of the probability of being able to realize the future benefits indicated by such asset. A valuation allowance related to a deferred tax asset is recorded when it is more likely than not that some portion or all of the deferred tax asset will not be realized. At the end of 2005, we had a full valuation allowance on our deferred tax assets. Based on our assessment of all available evidence, we concluded that it is more likely than not that our deferred tax assets will be fully realized in the future. This conclusion is based primarily on our improving financial performance and projected income in the future years. As a result, we released all of our valuation allowance in 2006. The release of the valuation allowance decreased our tax expense in 2006. In addition, effective January 1, 2007, the Company adopted FIN 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109*. Based on our evaluation, we have concluded that there are no significant uncertain tax positions requiring recognition in our financial statements.

*Share-Based Compensation* We currently account for the issuance of stock options to employees using the fair market value method according to SFAS No. 123R, *Share-Based Payment*.

**Recent Accounting Pronouncements**

In February 2006, the FASB issued Statement SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*, which amends SFAS No. 133, *Accounting for Derivatives Instruments and Hedging Activities* and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* (SFAS 155). SFAS 155 amends SFAS No. 133 to narrow the scope exception for interest-only and principal-only strips on debt instruments to include only such strips representing rights to receive a specified portion of the

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contractual interest or principle cash flows. SFAS 155 also amends SFAS No. 140 to allow qualifying special-purpose entities to hold a passive derivative financial instrument pertaining to beneficial interests that itself is a derivative instrument. We are currently evaluating the impact this new Standard but believe that it will not have a material impact on our financial position, results of operations, or cash flows.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* (SFAS 156), which provides an approach to simplify efforts to obtain hedge-like (offset) accounting. This Statement amends FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. The Statement (1) requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations; (2) requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable; (3) permits an entity to choose either the amortization method or the fair value method for subsequent measurement for each class of separately recognized servicing assets or servicing liabilities; (4) permits at initial adoption a one-time reclassification of available-for-sale securities to trading securities by an entity with recognized servicing rights, provided the securities reclassified offset the entity's exposure to changes in the fair value of the servicing assets or liabilities; and (5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the balance sheet and additional disclosures for all separately recognized servicing assets and servicing liabilities. SFAS 156 is effective for all separately recognized servicing assets and liabilities as of the beginning of an entity's fiscal year that begins after September 15, 2006, with earlier adoption permitted in certain circumstances. The Statement also describes the manner in which it should be initially applied. Accordingly, we have adopted SFAS 156 effective January 1, 2007. The adoption of SFAS 156 did not have a material impact on our financial position, results of operations or cash flows.

In July 2006, the FASB released FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting and reporting for uncertainties in income tax law. This interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. On January 17, 2007, the FASB affirmed its previous decision to make FIN 48 effective for fiscal years beginning after December 15, 2006. Accordingly, we have adopted FIN 48 effective January 1, 2007. The adoption of FIN 48 did not have a material impact on our results of operation and financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines the fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is encouraged, provided that we have not yet issued financial statements for that fiscal year, including any financial statements for an interim period within that fiscal year. We are currently in the process of evaluating the impact SFAS 157 may have on our results of operations and financial position.

In October 2006, the Emerging Issues Task Force (EITF) issued EITF 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That is, Gross versus Net Presentation)* to clarify diversity in practice on the presentation of different types of taxes in the financial statements. The Task Force concluded that, for taxes within the scope of the issue, a company may adopt a policy of presenting taxes either gross within revenue or net. That is, it may include charges to customers for taxes within revenues and the charge for the taxes from the taxing authority within cost of sales, or, alternatively, it may net the charge to the customer and the charge from the taxing authority. If taxes subject to EITF 06-3 are significant, a company is required to disclose its accounting policy for presenting taxes and the amounts of such taxes that are recognized on a gross basis. The guidance in this consensus is effective for the first interim reporting period beginning after December 15, 2006 (the first quarter of our fiscal year 2007). The application of EITF 06-3 has not had a material impact on our results of operations, financial position or cash flow.

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In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. Subsequent changes in fair value for designated items will be required to be reported in earnings in the current period. SFAS 159 also establishes presentation and disclosure requirements for similar types of assets and liabilities measured at fair value. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the effect of implementing this guidance, which directly depends on the nature and extent of eligible items elected to be measured at fair value, upon initial application of the standard on January 1, 2008.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations*. The objective of SFAS 141 (R) is to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations, resulting in more complete, comparable and relevant information for investors and other users of financial statements. SFAS 141 (R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. SFAS 141 (R) includes both core principles and pertinent application guidance, eliminating the need for numerous EITF issues and other interpretative guidance, thereby reducing the complexity of existing GAAP. SFAS 141 (R) is effective as of the start of fiscal years beginning after December 15, 2008. Early adoption is not allowed. We are in the process of evaluating this standard and have not yet determined the impact that the adoption of SFAS 141 (R) will have on our financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, *Non-controlling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 improves the relevance, comparability, and transparency of financial information provided to investors by requiring all entities to report non-controlling (minority) interests in subsidiaries in the same way as equity in the consolidated financial statements. Moreover, SFAS 160 eliminates the diversity that currently exists in accounting for transactions betwe