

SOCKET MOBILE, INC.  
Form 10-Q  
November 14, 2018

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2018**

OR

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

For the transition period \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 1-13810

**SOCKET MOBILE, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**                      **94-3155066**  
(State of incorporation) (IRS Employer Identification No.)

**39700 Eureka Drive, Newark, CA 94560**

(Address of principal executive offices including zip code)

**(510) 933-3000**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES [ X ] NO [ ]

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Emerging growth company

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

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

The number of shares of Common Stock (\$0.001 par value) outstanding as of November 7, 2018 was 5,883,109 shares.

**INDEX**

	PAGE NO.
<u>Part I. Financial Information</u>	
<u>Item 1. Financial Statements (Unaudited):</u>	
<u>Condensed Statements of Operations - Three and Nine Months Ended September 30, 2018 and 2017</u>	<u>1</u>
<u>Condensed Balance Sheets - September 30, 2018 and December 31, 2017</u>	<u>2</u>
<u>Condensed Statements of Cash Flows - Nine Months Ended September 30, 2018 and 2017</u>	<u>3</u>
<u>Notes to Financial Statements</u>	<u>4</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>13</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>20</u>
<u>Item 4. Controls and Procedures</u>	<u>21</u>
<u>Part II. Other Information</u>	
<u>Item 1A. Risk Factors</u>	<u>22</u>
<u>Item 6. Exhibits</u>	<u>33</u>
<u>Signatures</u>	<u>34</u>
<u>Index to Exhibits</u>	<u>35</u>

Index**PART I****Item 1. Financial Statements**

**SOCKET MOBILE, INC.**  
**CONDENSED STATEMENTS OF OPERATIONS**  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
Revenues	\$4,136,593	\$5,475,475	\$12,309,979	\$16,903,173
Cost of revenues	1,959,956	2,429,036	5,937,026	7,834,378
Gross profit	2,176,637	3,046,439	6,372,953	9,068,795
Operating expenses:				
Research and development	884,497	873,830	2,748,310	2,529,210
Sales and marketing	738,804	737,276	2,210,499	2,238,081
General and administrative	584,256	659,575	1,874,069	1,949,673
Total operating expenses	2,207,557	2,270,681	6,832,878	6,716,964
Operating income (loss)	(30,920 )	775,758	(459,925 )	2,351,831
Interest expense, net	(31,919 )	(20,892 )	(99,819 )	(81,246 )
Net income (loss) before income taxes	(62,839 )	754,866	(559,744 )	2,270,585
Income tax benefit (expense)	17,582	(340,765 )	151,216	(980,754 )
Net income (loss)	\$(45,257 )	\$414,101	\$(408,528 )	\$1,289,831
Net income (loss) per share:				
Basic	\$(0.01 )	\$0.07	\$(0.07 )	\$0.21
Diluted	\$(0.01 )	\$0.06	\$(0.07 )	\$0.19

Weighted average shares outstanding:

Edgar Filing: SOCKET MOBILE, INC. - Form 10-Q

Basic	5,883,109	6,261,460	6,166,017	6,047,869
Diluted	5,883,109	7,129,633	6,166,017	6,936,210

See accompanying notes.

1

IndexSOCKET MOBILE, INC.  
CONDENSED BALANCE SHEETS

	September 30, 2018	December 31, 2017
	(Unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$1,324,230	\$3,379,508
Accounts receivable, net	2,531,672	2,687,325
Inventories, net	1,893,213	2,198,266
Prepaid expenses and other current assets	313,850	385,508
Deferred cost on shipments to distributors	195,932	204,405
Total current assets	6,258,897	8,855,012
Property and equipment:		
Machinery and office equipment	2,270,135	2,052,091
Computer equipment	976,262	851,823
	3,246,397	2,903,914
Accumulated depreciation	(2,485,206 )	(2,241,010 )
Property and equipment, net	761,191	662,904
Goodwill	4,427,000	4,427,000
Other long-term assets	246,960	271,650
Deferred tax assets	5,788,695	5,637,480
Total assets	\$17,482,743	\$19,854,046
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$1,207,471	\$1,112,234
Accrued payroll and related expenses	528,765	630,999
Deferred revenue on shipments to distributors	479,361	492,611
Current portion of deferred service revenue	31,573	31,536
Lines of credit	1,526,690	—
Term loan – current portion	500,000	—
Current portion of capital leases and deferred rent	58,110	55,382
Total current liabilities	4,331,970	2,322,762
Long-term portion of deferred service revenue	27,490	29,447
Long-term portion of capital leases and deferred rent	224,034	271,414
Term loan – long-term portion	458,333	—

Edgar Filing: SOCKET MOBILE, INC. - Form 10-Q

Total liabilities	5,041,827	2,623,623
Commitments and contingencies	—	—
Stockholders' equity:		
Common stock, \$0.001 par value: Authorized – 20,000,000 shares, Issued and outstanding – 5,883,109 shares at September 30, 2018 and 7,011,128 shares at December 31, 2017	5,883	7,011
Additional paid-in capital	60,397,769	64,777,620
Accumulated deficit	(47,962,736)	(47,554,208)
Total stockholders' equity	12,440,916	17,230,423
Total liabilities and stockholders' equity	\$17,482,743	\$19,854,046

See accompanying notes.



Index

SOCKET MOBILE, INC.  
 CONDENSED STATEMENTS OF CASH FLOWS  
 (Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Operating activities		
Net income (loss)	\$(408,528 )	\$1,289,831
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Stock-based compensation	361,674	315,237
Depreciation and amortization	314,770	236,059
Change in deferred taxes	(151,215 )	926,464
Changes in operating assets and liabilities:		
Accounts receivable	155,653	(547,020 )
Inventories	305,053	(708,850 )
Prepaid expenses and other current assets	71,658	(186,482 )
Other assets	435	12,881
Accounts payable and accrued expenses	91,850	(9,478 )
Accrued payroll and related expenses	(102,234 )	2,997
Net deferred income on shipments to distributors	(4,777 )	109,011
Customer deposit	—	56,700
Deferred service revenue	(1,920 )	(8,749 )
Change in deferred rent	(19,976 )	(7,299 )
Net cash provided by operating activities	612,443	1,481,302
Investing activities		
Purchases of equipment	(388,802 )	(196,190 )
Net cash used in investing activities	(388,802 )	(196,190 )
Financing activities		
Payments on capital leases	(21,289 )	(19,921 )
Proceeds from borrowings under bank line of credit agreement	9,416,353	—
Repayments of borrowings under bank line of credit agreement	(7,889,663)	—
Proceeds from bank term loan	4,000,000	—
Repayments of bank term loan	(3,041,667)	—
Common stock repurchases and related expenses	(5,021,830)	—
Stock options exercised	279,177	282,826
Net cash (used in) provided by financing activities	(2,278,919)	262,905
Net change in cash and cash equivalents	(2,055,278)	1,548,017
Cash and cash equivalents at beginning of period	3,379,508	1,319,006
Cash and cash equivalents at end of period	\$1,324,230	\$2,867,023

Supplemental disclosure of cash flow information		
Cash paid for interest	\$86,754	\$2,339
Supplemental disclosure of non-cash investing and financing activities		
Conversion of notes payable and accrued interest into common stock	\$—	\$1,216,109

See accompanying notes.

3

Index

**SOCKET MOBILE, INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)**

**NOTE 1 — Basis of Presentation**

The accompanying unaudited financial statements of Socket Mobile, Inc. (the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring accruals considered necessary for fair presentation have been included. The results of operations for the interim periods are not necessarily indicative of the operating results for the full fiscal year or any future period. These financial statements should be read in conjunction with the audited financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

**NOTE 2 — Summary of Significant Accounting Policies**

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates, and such differences may be material to the financial statements.

*Cash Equivalents and Fair Value of Financial Instruments*

The Company considers all highly liquid investments purchased with a maturity date of 90 days or less at date of purchase to be cash equivalents. At September 30, 2018 and December 31, 2017, all of the Company’s cash and cash equivalents consisted of amounts held in demand deposit accounts in banks. The aggregate cash balance on deposit in these accounts are insured by the Federal Deposit Insurance Corporation up to \$250,000. The Company’s cash balance on deposit in these accounts may, at times, exceed the federally insured limits. The Company has never experienced

any losses in such accounts.

The carrying value of the Company's cash and cash equivalents, accounts receivable, accounts payable, debt and foreign exchange contracts approximate fair value due to the relatively short period of time to maturity.

*Revenue Recognition and Deferred Revenue*

The Company adopted the new revenue recognition policy (ASC 606 "Revenue from Contracts with Customers") effective January 1, 2017. Instead of deferring 100% of revenue and cost of revenue until products are sold by distributors, the new policy recognizes revenue on sales to distributors when shipping of product is completed and title transfers to the distributor, less a reserve for estimated product returns (sales and cost of sales). The reserves are based on estimates of future returns calculated from actual return history plus knowledge of pending returns outside of the norm. Actual return history is approximately 18% of the channel inventory, primarily from stock rotations. On January 1, 2017, the Company recorded a one-time reduction (debit) to net deferred revenue in the amount of \$836,000 less the deferred tax effects of \$333,000 for a net improvement in retained deficit of \$503,000. At September 30, 2018, the deferred revenue and deferred cost on shipments to distributors were approximately \$479,000 and \$196,000 respectively, compared to approximately \$493,000 and \$204,000, respectively, at December 31, 2017.

Index**SOCKET MOBILE, INC.****NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)***Recently Issued Financial Accounting Standards*

In August 2018, the FASB issued Accounting Standards Update (ASU) 2018-13, Fair Value Measurement (Topic 820) Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in ASU 2018-13 apply to all entities that are required GAAP, to make disclosures about recurring or nonrecurring fair value measurements. ASU 2018-13 removes, modifies, and adds certain disclosure requirements in ASC 820, Fair Value Measurement. ASU 2018-13 is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, and early adoption is permitted. The Company is currently evaluating the impact of adopting ASU 2018-13 on its condensed financial statements.

In August 2018, the FASB issued ASU 2018-15, Intangibles - Goodwill and Other-Internal-Use Software (“ASU 2018-15”), which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. This guidance is effective for interim and annual reporting periods beginning after December 15, 2019, and early adoption is permitted. The Company is currently evaluating the impact of adopting ASU 2018-15 on its condensed financial statements.

From time to time, new accounting pronouncements are issued by the FASB or other standards setting bodies that are adopted by the Company as of the specified effective date. Unless otherwise discussed, management believes that the impact of recently issued standards that are not yet effective will not have a material impact on the Company’s financial position, results of operations or cash flows.

**NOTE 3 — Inventories**

Inventories consist principally of raw materials and sub-assemblies, which are stated at the lower of cost (first-in, first-out) or market. Inventories at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018	December 31, 2017
Raw materials and sub-assemblies	\$2,705,323	\$3,016,327
Finished goods	58,635	67,120

Inventory reserves	(870,745 )	(885,181 )
Inventories, net	\$1,893,213	\$2,198,266

Index

**SOCKET MOBILE, INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)**

**NOTE 4 — Short Term Related Party Convertible Notes Payable**

The Company's Subordinated Convertible Notes of \$752,625 matured on September 4, 2017. At the option of the note holders, note payable principal and accrued interest totaling \$1,216,109 was converted into 972,884 shares of common stock at a conversion rate of \$1.25 per share. The conversion reduced current liabilities and increased stockholders' equity by \$1,216,109. These 4-year notes were originally issued on September 4, 2013 to officers and directors of the company and converted into common stock at maturity pursuant to the terms of the notes.

Interest expense on these convertible notes for the three and nine months ended September 30, 2017 was \$22,179 and \$80,676, respectively.

**NOTE 5 — Bank Financing Arrangements**

*Third Financing Agreement*

On January 31, 2018, the Company entered into an Amended and Restated Business Financing Agreement (the "Third Financing Agreement") with Western Alliance Bank (the "Bank"), that provides for a \$2.5 million revolving line of credit and a \$4.0 million term loan that the Company may use to repurchase shares of common stock. Pursuant to the revolving line of credit, the Company is permitted to borrow up to the lesser of \$2.5 million or 80% of eligible accounts receivables. Amounts outstanding under the line of credit bear interest at the "U.S. Prime Rate" published by the Wall Street Journal plus 0.75%. Interest is payable monthly on the line of credit, and the principal is due upon the maturity date of January 31, 2020. Amounts outstanding under the term loan bear interest at the "U.S. Prime Rate" published by the Wall Street Journal plus 1.75%. Following a three-month interest only period, the term loan is payable in 45 equal monthly installments of principal and interest (see "Forth Financing Agreement" and "Fifth Financing Agreement" for subsequent changes affecting the term loan and financial covenants). The loans are secured by all of the Company's present and future assets, including intellectual property and general intangibles. Termination of the revolving line of credit or term loan prior to its termination date may be subject to early termination fees, subject to certain exceptions. Amounts repaid or prepaid under the term loan may not be reborrowed. At the end of each quarter through the quarter ending December 31, 2018, the Company is required to prepay outstanding term loan principal in an amount equal to 25% of excess cash flow, as set forth in the Third Financing Agreement, for the most recent quarter ended. The Company is also obligated to pay customary fees for a loan facility of this size and type.

The Third Financing Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company's ability to, among other things, grant liens, make investments, incur indebtedness, merge or consolidate, dispose of assets, make acquisitions, pay dividends or make distributions, repurchase stock, enter into transactions with affiliates and enter into restrictive agreements, in each case subject to customary exceptions for a credit facility of this size and type. The Company is also required to maintain compliance with an asset coverage ratio (unrestricted cash maintained with the Bank plus Eligible Receivables, divided by the total amount of the Obligations) measured monthly, which requirements increase during the term of the Financing Agreement, a fixed charge coverage ratio of no less than 1.75 to 1.0, measured quarterly, and a total funded debt to trailing twelve months EBITDA multiple of not more than 1.75 to 1.0, measured monthly.



Index

**SOCKET MOBILE, INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)**

The Third Financing Agreement also contains customary events of default including, among others, payment defaults, breaches of covenants, bankruptcy and insolvency events, cross defaults with certain material indebtedness, judgment defaults, and breaches of representations and warranties. Upon an event of default, the Bank may declare all or a portion of the Company's outstanding obligations payable to be immediately due and payable and exercise other rights and remedies provided for under the Financing Agreement. During the existence of an event of default, interest on the obligations could be increased.

On March 1, 2018, the Company received proceeds of \$4.0 million under the provisions of the term loan for a common stock repurchase. On March 9, 2018, the Company completed a tender offer to purchase and retire 1,250,000 shares of common stock from multiple investors at a purchase price of \$3.90 per share, for an aggregate cost of approximately \$4.9 million, excluding fees and expenses relating to the tender offer.

On April 12, 2018, the Company advised the Bank that its operating results for the quarter ended March 31, 2018 were not expected to be in compliance with two financial covenants, the first a Fixed Charge Coverage Ratio and the second a Total Funded Debt to EBITDA ratio. The Company reported the non-compliance in its Form 10-Q for the quarter ended March 31, 2018. The Bank verbally agreed to forbear the events of default subject to further modification of the Financing Agreement. The Company subsequently paid down the term loan from \$4.0 million at March 31, 2018 to \$1.0 million at June 30, 2018. The paydowns were made from its cash and revolving lines of credit.

*Fourth Financing Agreement*

On June 4, 2018, the Company entered into an Amended and Restated Business Financing Agreement (the "Fourth Financing Agreement") with the Bank. In the Fourth Financing Agreement, the Bank recognizes the repayment of the outstanding term loan balance to \$1.0 million by June 30, 2018. The remaining balance is repayable in 24 equal monthly installments. The Fixed Charge Coverage Ratio is replaced with a commitment to maintain cash plus available credit at or above the term loan balance. The Total Funded Debt to EBITDA ratio and the excess cash flow application provisions that were designed to accelerate the pay down of the term loan balance are removed. The Bank permanently waived the defaults resulting from March 31, 2018 results when paydown of the term loan balance to \$1.0 million by June 30, 2018 was achieved. In the Fourth Financing Agreement, the Company is required to maintain compliance with the Asset Coverage Ratio measured monthly.

*Fifth Financing Agreement*

On July 30, 2018, the Company entered into an Amended and Restated Business Financing Agreement (the “Fifth Financing Agreement”) with the Bank. The Company is required to maintain daily cash plus available credit at or above 90% of the outstanding principal balance of the term loan until the Asset Coverage Ratio is at 1.25 to 1.0. The minimum Asset Coverage Ratio increased to 1.2 to 1.0 on October 1, 2018. From December 31, 2018 onwards, the ratio will increase to 1.25 to 1.0.

Index**SOCKET MOBILE, INC.****NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)**

The Company was in complete compliance with all the required covenants during Q3 2018. On September 30, 2018, the sum of Company's unrestricted cash on deposit with the Bank plus availability was \$1.62 million, \$0.76 million more than 90% of the outstanding principal balance of the term loan, or \$0.86 million, and the Asset Coverage Ratio was 1.48 to 1.0.

During the nine months ended September 30, 2018, the total amount borrowed under the term loan was \$4.0 million and total repayments was \$3.04 million. Total amount borrowed under the domestic and international lines was \$9.416 million and the total repayments was \$7.89 million. Amounts outstanding under the term loan and bank credit facilities at September 30, 2018 are as follows:

	September 30, 2018
Term loan	958,333
Less: current-portion of term loan	(500,000)
Long-term portion of term loan	\$458,333

	September 30, 2018
Lines of credit -domestic line	1,233,584
Lines of credit -EXIM line	293,106
Total lines of credit	\$1,526,690

Interest expense on the term loan for three and nine months ended September 30, 2018 was \$19,459 and \$76,188, respectively. Interest expense on the amounts drawn under the Company's bank credit lines during the three and nine months ended September 30, 2018 was \$12,483 and \$26,880, respectively. Accrued interest payable related to the amounts outstanding under the term loan and bank credit facilities at September 30, 2018 was \$9,244.

**NOTE 6 — Segment Information and Concentrations**

*Segment Information*

The Company operates in the mobile data capture market. Mobile data capture typically consists of mobile devices such as smartphones or tablets, with the Company's mobile scanning and RFID/NFC peripherals for data collection, and third-party vertical applications software. The Company distributes its products in the United States and foreign countries primarily through distributors and resellers. The Company markets its products primarily through application developers whose applications are designed to work with Company's products. Revenues for the geographic areas for three and nine-month periods ended September 30, 2018 and 2017 were as follows:

Index**SOCKET MOBILE, INC.****NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)**

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenues:				
United States	\$3,256,758	\$4,430,409	\$9,573,354	\$13,438,873
Europe	533,414	711,057	1,816,803	2,642,265
Asia and rest of world	346,421	334,009	919,822	822,035
Total revenues	\$4,136,593	\$5,475,475	\$12,309,979	\$16,903,173

Export revenues are attributable to countries based on the location of the Company's customers. The Company does not hold long-lived assets in foreign locations.

*Major Customers*

Customers who accounted for at least 10% of the Company's total revenues in the three and nine-month periods ended September 30, 2018 and 2017 were as follows:

	Three		Nine	
	Months		Months	
	Ended	Ended	Ended	Ended
	September	September	September	September
	30,	30,	30,	30,
	2018	2017	2018	2017
Ingram Micro Inc.	30%	40%	32%	39%
BlueStar, Inc.	25%	20%	23%	17%
ScanSource, Inc.	11%	10%	10%	17%

---

\* Customer accounted for less than 10% of total revenues for the period

*Concentration of Credit Risk*

Financial instruments that potentially subject the Company to significant concentrations of credit risk include cash, cash equivalents and accounts receivable. The Company invests its cash in demand deposit accounts in banks. To date, the Company has not experienced losses on the investments. The Company's trade accounts receivables are primarily with distributors. The Company performs ongoing credit evaluations of its customers' financial condition, but the Company generally requires no collateral. Reserves are maintained for potential credit losses, and such losses have been within management's expectations. Customers who accounted for at least 10% of the Company's net accounts receivable balances at September 30, 2018 and December 31, 2017 were as follows:

	September 30, 2018		December 31, 2017	
Ingram Micro Inc.	40	%	37	%
BlueStar, Inc.	26	%	23	%
ScanSource, Inc.	*		10	%
Ingram Micro Pan Europe GmbH.	*		10	%

---

\* Customer accounted for less than 10% of total accounts receivable balances

Index**SOCKET MOBILE, INC.****NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)***Concentration of Suppliers*

Several of the Company's component parts are produced by a sole or limited number of suppliers. Shortages could occur in these essential materials due to increased demand, or to an interruption of supply. Suppliers may choose to restrict credit terms or require advance payments causing delays in the procurement of essential materials. If the Company were unable to procure certain of such materials, it could have a material adverse effect upon its results. At September 30, 2018 and December 31, 2017, 32% and 22%, respectively, of the Company's accounts payable balances were concentrated with two suppliers. During the nine-month periods ended September 30, 2018 and 2017, the top two suppliers accounted for 49% and 53%, respectively, of the inventory purchases.

**NOTE 7 — Stock-Based Compensation**

The Company recognizes the compensation cost in the financial statements for all stock-based awards to employees, including grants of employee stock options, based on the fair value of the awards as of the date that the awards are issued. The fair values of stock options are generally determined using a binomial lattice valuation model that incorporates assumptions about expected volatility, risk-free interest rate, dividend yield, and expected life. Compensation cost for stock-based awards is recognized on a straight-line basis over the vesting period. Total stock-based compensation expense for the three and nine months ended September 30, 2018, was \$130,698 and \$361,674, respectively. Total stock-based compensation expense for the three and nine months ended September 30, 2017 was \$112,151 and \$315,237, respectively. No stock options were granted in Q3 2018. During the nine months ended September 30, 2018, 259,700 stock options were granted at an estimated weighted average per share fair value of \$1.65.

**NOTE 8 — Net Income (Loss) per Share Applicable to Common Stockholders**

The following table sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended		Nine Months Ended	
	September 30, 2018	2017	September 30, 2018	2017
Numerator:				

Edgar Filing: SOCKET MOBILE, INC. - Form 10-Q

Net income (loss)		\$(45,257 )	\$414,101	\$(408,528 )	\$1,289,831
Denominator:					
Weighted average common shares outstanding used in computing net income (loss) per share:					
Basic		5,883,109	6,261,460	6,166,017	6,047,869
Effect of dilutive stock options		—	868,173	—	888,341
Diluted		5,883,109	7,129,633	6,166,017	6,936,210
Net income (loss) per share applicable to common stockholders:					
Basic		\$(0.01 )	\$0.07	\$(0.07 )	\$0.21
Diluted		\$(0.01 )	\$0.06	\$(0.07 )	\$0.19



Index**SOCKET MOBILE, INC.****NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)**

In the three and nine months ended September 30, 2018, 2,358,059 stock options were excluded in the calculation of diluted net loss per share because their effect would be anti-dilutive.

**NOTE 9 — Taxes**

The Tax Cuts and Jobs Act of 2017, effective on January 1, 2018, eliminates alternative minimum taxes and lowers the U.S. federal corporate income tax from 34% to 21%. Net loss in the three and nine months ended September 30, 2018 resulted in a setup of additional deferred tax assets with a 20- year expiration. Net operating loss carryforwards do not begin expiring until the end of 2023 if not used. The Company expects a return to profitable operating results and full utilization of the NOL benefits. In the three and nine months ended September 30, 2018, the Company recorded deferred tax benefits of \$17,582 and \$151,216, respectively. In the same periods one year ago, the Company recorded income tax expenses of \$340,765 and \$980,754, respectively.

**NOTE 10 — Commitments and Contingencies***Operating Lease*

The Company leases office space under a non-cancelable operating lease that provides the Company approximately 37,100 square feet in Newark, California. The lease agreement expires on June 30, 2022. Monthly base rent increases four percent annually on July 1<sup>st</sup> of each year. Rental expense was \$109,285 and \$329,203 for the three and nine-month periods ended September 30, 2018, respectively. Rental expense was \$108,473 and \$326,509 for the three and nine-month periods ended September 30, 2017, respectively. The Company's accrued liabilities include a deferred rent obligation in the amount of \$254,412 and \$274,388 at September 30, 2018 and December 31, 2017, respectively.

Future minimum lease payments under the operating lease at September 30, 2018 are shown below:

Annual minimum payments:	Amount
2018 (October 1, 2018 to December 31, 2018)	\$112,758
2019	460,053
2020	478,455

2021	497,594
2022 (through June 30, 2022)	253,675
Total minimum payments	\$1,802,535

Index**SOCKET MOBILE, INC.****NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)***Capital Lease Obligations*

The Company leases certain of its equipment under capital leases. The leases are collateralized by the underlying assets. At September 30, 2018 and December 31, 2017, property and equipment with a cost of \$100,584 was subject to such financing arrangements. The accumulated depreciation of the assets associated with the capital leases as of September 30, 2018 and December 31, 2017, amounted to \$72,539 and \$51,400 respectively.

Future minimum payments under capital lease and equipment financing arrangements as of September 30, 2018 are as follows:

Annual minimum payments:	Amount
2018 (October 1, 2018 to December 31, 2018)	\$4,192
2019	16,838
2020	8,454
Total minimum payments	29,484
Less amount representing interest	(1,752 )
Present value of net minimum payments	27,732
Short term portion of capital leases	(15,400)
Long term portion of capital leases	\$12,332

*Purchase Commitments*

As of September 30, 2018, the Company has non-cancelable purchase commitments for inventory to be used in the ordinary course of business of approximately \$5,139,000.

*Legal Matters*

The Company is subject to disputes, claims, requests for indemnification and lawsuits arising in the ordinary course of business. Under the indemnification provisions of the Company's customer agreements, the Company routinely agrees to indemnify and defend its customers against infringement of any patent, trademark, copyright, trade secrets, or other intellectual property rights arising from customers' legal use of the Company's products or services. The exposure to the Company under these indemnification provisions is generally limited to the total amount paid for the indemnified products. However, certain indemnification provisions potentially expose the Company to losses in excess of the aggregate amount received from the customer. To date, there have been no claims against the Company by its customers pertaining to such indemnification provisions, and no amounts have been recorded. The Company is

currently not a party to any material legal proceedings.

Index

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

*This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include statements forecasting our future financial condition and results, our future operating activities, market acceptance of our products, expectations for general market growth of mobile computing devices, growth in demand for our data capture products, expansion of the markets that we serve, expansion of the distribution channels for our products, and the timing of the introduction and availability of new products, as well as other forecasts discussed under “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Words such as “may,” “will,” “predicts,” “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” variations of such words, and similar expressions are intended to identify such forward-looking statements. Such forward-looking statements are based on current expectations, estimates, and projections about our industry, management’s beliefs, and assumptions made by management. These forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties, and assumptions that are difficult to predict; therefore, actual results and outcomes may differ materially from what is expressed or forecasted in any such forward looking statements. Factors that could cause actual results and outcomes to differ materially include, but are not limited to: volatility in the world economy generally and in the markets we serve in particular; the risk of delays in the availability of our products due to technological, market or financial factors including the availability of product components and necessary working capital; our ability to successfully develop, introduce and market future products; our ability to effectively manage and contain our operating costs; the availability of third-party hardware and software that our products are intended to work with; product delays associated with new model introductions and product changeovers by the makers of products that our products are intended to work with; continued growth in demand for barcode scanners; market acceptance of emerging standards such as RFID/Near Field Communications and of our related data capture products; the ability of our strategic relationships to benefit our business as expected; our ability to enter into additional distribution relationships; or other factors described in this Form 10-Q including “Item 1A. Risk Factors” and recent Form 8-K and Form 10-K reports filed with the Securities and Exchange Commission. We assume no obligation to update such forward-looking statements or to update the reasons why actual results could differ materially from those anticipated in such forward-looking statements.*

*You should read the following discussion in conjunction with the interim condensed financial statements and notes included elsewhere in this report, the Company’s annual financial statements in form 10-K, and other information contained in other reports and documents filed from time to time with the Securities and Exchange Commission.*

Index

The Company

We are a leading producer of data capture products for mobile applications used in Retail, Commercial Services, Industrial & Manufacturing, Transportation & Logistics, and Health Care. Our primary products are cordless data capture devices that connect over Bluetooth and work with applications running on smartphones, tablets and mobile computers using operating systems from Apple® (iOS), Google™ (Android™) and Microsoft® (Windows®). We focus on serving the needs of software application developers as scanner sales are primarily driven by the deployment of barcode and RFID/NFC enabled mobile applications.

We design our own products and subcontract the manufacturing of product components to independent third-party contract manufacturers who are in the U.S., Mexico, Singapore, China, Malaysia, and Taiwan and who have the equipment, know-how and capacity to manufacture products to our specifications. Final products are assembled, tested, packaged, and distributed at and from our Newark, California facility. We offer the products worldwide through two-tier distribution enabling customers to purchase from a large number of on-line resellers around the world including some application developers. The geographic regions served by the Company include the Americas, Europe, Asia Pacific and Africa.

We believe growth in mobile applications and the mobile workforce are resulting from technical advances in mobile technologies, cost reductions in mobile devices and the growing adoption by businesses of mobile applications running on smartphones and tablets, building a growing demand for our products. Our data capture products address the growing need for speed and accuracy by today's mobile workers and by the systems supporting those workers, thereby enhancing their productivity and allowing them to exploit time sensitive opportunities and improve customer satisfaction.

**Products**

*Cordless scanners*

We offer a full range of handheld cordless barcode scanners connecting to smartphones, tablets and other computing devices over Bluetooth ("Companion Scanners"). Our 7 Series standard barcode scanners are lightweight and ergonomically designed for easy handling as stand-alone cordless barcode scanners. The 7 Series scanners come in six vivid colors, blue, gray, green, red, white and yellow. In April 2018, we introduced our SocketScan® 700 Series colorful barcode scanners to replace the 7 Series before the end of 2018. The SocketScan® 700 Series come in three models: linear imager (S700), laser (S730) and 2D imager (S740) in five vivid colors: blue, green, red, white and yellow. Our DuraScan® line of durable barcode scanners come in four models: linear imager (D700), laser (D730) and 2D imager (D740 and D750). Using the same ergonomic form factor, these barcode scanners have an IP54 durability rating and improved usability features in industrial colors: Construction Orange, Safety Green and Utility

Gray. Our SocketScan® 800 Series cordless barcode scanners in linear imaging (S800) and 2D models (S850) are designed to be attachable, with an easily detachable clip, to smartphones and other mobile devices for more integrated barcode scanning. The 800 Series scanners can also be used in simple handheld mode. Our 800 Series sleeve solution, “DuraCase”, is designed to keep an iPod or smartphone and barcode scanner together and enable both devices to be used and charged simultaneously and easily operated with a single hand. We are a leading supplier of Companion Scanners.

Index

*Contactless RFID/NFC Reader/Writer*

Our Contactless RFID/NFC Reader/Writer version of durable handheld scanner, D600, can read and write many different types of electronic SmartTags. SmartTags are used in many applications today, like digital wallet applications for loyalty cards, identification cards, payment cards, coupons, event tickets and others which leverage the exchange of electronic “tokens”. We are working with our registered application developers to encourage them to include Near Field Communications capabilities in their mobile applications. We are an early entrant into this market and do not face significant head to head competition from alternative reader/writer devices.

*Software Developer Kit (Capture SDK)*

Our Software Developer Kit (Capture SDK) supports all of our data capture devices (both barcode reader and RFID/NFC Reader/Writer) with a single installation, making it easy for registered third-party application developers to integrate our data capture capabilities into their application centric solution while giving the customers the ability to select the products that work best for them. Our Capture SDK enables the developers to modify the placement of the captured data in their application and control the feedback to the users that the transaction and transmission were successfully completed. It also enables the built-in camera in a customer’s smartphone or tablet to be used for occasional or lower volume data collection requirements. In April 2018, we introduced a new Capture SDK which was restructured to better support our existing iOS and Android developers by enabling the use of commercial developer tools including Xamarin and Java. The new Capture SDK also integrates well with software build environments such as CocoaPods, Maven and NuGet, making it easier and quicker for the corporate developers to build the use of Socket Mobile products into their applications.

*Service*

Our products are warranted for one year and we offer SocketCare extended warranty programs for up to five years including repair or replacement due to accidental breakage. We also repair or replace products that are beyond their warranty period.





Index**Revenues**

Revenue for the third quarter of 2018 was \$4.1 million, a decrease of 24 percent compared to revenue of \$5.5 million for the same quarter a year ago. For the nine months ended September 30, 2018, revenue was \$12.3 million, a decrease of 27 percent compared to revenue of \$16.9 million for the same period a year ago. Our product revenues and the corresponding decrease in revenues for the comparable periods are shown in the following table:

(revenues in thousands)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Increase (Decrease)	2018	2017	Increase (Decrease)
Cordless scanners and accessories	\$4,083	\$5,022	(19 %)	\$12,105	\$16,258	(26 %)
OEM/Legacy products	—	385	(100 %)	52	467	(89 %)
Services	54	68	(21 %)	153	178	(14 %)
Total	\$4,137	\$5,475	(24 %)	\$12,310	\$16,903	(27 %)

Revenue of our *cordless scanners and accessories* decreased by 19% or \$0.9 million in the third quarter of 2018, compared to the same quarter a year ago. Revenue for the nine months ended September 30, 2018 was \$12.1 million, a decrease of 26% or \$4.2 million compared to the revenue of \$16.3 million in the same period a year ago. In 2018, we experienced lower enterprise deployments. For the nine months ended September 30, 2018, revenue from enterprise deployments was \$0.5 million, compared to revenue of \$2.22 million for the same period a year ago. Shipments in 2018 were primarily fulfilling smaller unit orders. Delays in shipping of our new SocketScan® products in the first and early second quarter of 2018 and the related product transition also affected our revenue in 2018. At the beginning of the year, we announced our expectation to launch our newest product line, SocketScan® series in mid-Q1 but the actual shipments commenced in late April due to some technical issues. Most of our application partners have completed their evaluations and are in the process of changing guidance to their customers to purchase our newest products. We expect to complete the product transition during Q4 this year.

*Service* comprised 1% of revenue for the three and nine-month periods ended September 30, 2018 and 2017. Our SocketCare service contracts are purchased by our customers in conjunction with the purchase of cordless barcode scanners. Due to the robustness and lower cost of the data capture products, service revenue continues to be a small portion of the total revenue.

## Gross Margins

Our gross margins on sales for the three and nine months ended September 30, 2018 were 52.6% and 51.8%, respectively, down from gross margins of 55.6% and 53.7%, respectively, for the corresponding periods a year ago. The lower margins in 2018 reflected absorption of fixed manufacturing costs over a smaller number of units sold and higher costs associated with expedited production of the new products. Legacy products and services in the third quarter of 2017 contributed to the quarterly margins by 2.0 percent.

Index

**Research and Development Expense**

Research and development expense in the three and nine months ended September 30, 2018 were \$884,497 and \$2,748,310, an increase of 1% and 9% compared to expenses of \$873,830 and \$2,529,210 in the corresponding periods one year ago. Increase in the level of research and development expense was primarily due to higher personnel costs reflecting headcount additions to facilitate product development and meet more complex requirements of today's products. Research and development expense for the fourth quarter of 2018 is expected to moderately increase.

**Sales and Marketing Expense**

Sales and marketing expense in Q3 2018 remained flat compared 2017. For the nine months ended September 30, 2018, the expense was \$2,210,499, a decrease of 1% compared to \$2,238,081 in the corresponding period one year ago. Sales and marketing expense for the fourth quarter of 2018 is expected to moderately increase.

**General and Administrative Expense**

General and administrative expense in the three and nine months ended September 30, 2018 were \$584,256 and \$1,874,069, a decrease of 11% and 4% compared to the expenses of \$659,575 and \$1,949,673 in the same periods one year ago. General and administrative expense is expected to be flat in the fourth quarter of 2018 from the third quarter levels.

**Interest Expense, Net of Interest Income**

Interest expense and other, net of interest income and other, in the three and nine months ended September 30, 2018 was \$31,919 and \$99,819, respectively, compared to \$20,892 and \$81,246, respectively, in the same periods one year ago. Interest expense in 2018 was primarily related to interest on bank term loan and credit line facilities (see "NOTE 5 — Bank Financing Arrangements" for more information). Average outstanding balance of bank term loan and credit lines during the first nine months of 2018 was \$2.2 million. Interest expense in 2017 was primarily related to interest on subordinated convertible notes payable issued in 2012 and reissued in September of 2013 (see "NOTE 4 — Short-Term Related Party Convertible Notes Payable" for more information). Additionally, interest expense in each of the comparable periods includes interest on equipment lease financing obligations.

Interest income reflects interest earned on cash balances. Interest income was nominal in each of the comparable periods, reflecting low average rates of return.

Index

**Income Taxes**

The Tax Cuts and Jobs Act of 2017, effective on January 1, 2018, eliminates alternative minimum taxes and lowers the U.S. federal corporate income tax from 34% to 21%. We estimate our Federal and State effective tax rate to be 28 percent. On December 31, 2017, we remeasured the net deferred tax assets and posted a one-time reduction of \$2.6 million in deferred tax assets to reflect the lower realization rate to be applied commencing in 2018.

Net loss in the three and nine months ended September 30, 2018 results in a setup of additional deferred tax asset (tax loss carryforwards) with a 20-year expiration. Net operating loss carryforwards do not begin expiring until the end of 2023 if not used. We expect a return to profitable operating results and full utilization of the NOL benefits. In the three and nine months ended September 30, 2018, we recorded deferred tax benefits of \$17,582 and \$151,216, respectively. In the same periods one year ago, we recorded income tax expenses of \$340,765 and \$980,754, respectively. Our deferred tax asset, primarily representing future income tax savings from the application of net operating loss carry forwards, was valued at \$5,789,000 at September 30, 2018.

We have determined that utilization of existing net operating losses against future taxable income is not limited by Section 382 of the Internal Revenue Code. Future ownership changes, however, may limit our ability to fully utilize the existing net operating loss carryforwards against any future taxable income.

**Liquidity and Capital Resources**

As reflected in our Condensed Statements of Cash Flows, net cash provided by operating activities was \$612,443 and \$1,481,302 in the first nine months of 2018 and 2017, respectively.

We calculate net cash provided by operating activities by decreasing our net loss (\$408,528 in the first nine months of 2018) or increasing our net income (\$1,289,831 in the first nine months of 2017) by the expenses and benefits, such as stock-based compensation expense, depreciation, and deferred tax expense and benefits, that did not require the use of or generate cash. These amounts totaled \$525,229 and \$1,477,760 in the first nine months of 2018 and 2017, respectively. In addition, we report increases in assets and reductions in liabilities as uses of cash and decreases in assets and increases in liabilities as sources of cash, together referred to as changes in operating assets and liabilities.

In the first nine months of 2018, changes in operating assets and liabilities resulted in a net source of cash of \$496,000 which resulted from lower inventory levels due to the reduction of component order sizes, a decrease in accounts

receivable due to lower overall shipments to our distributors, and an increase in accounts payable due to the timing of vendor payments. The source of cash was partially offset by a decrease of accrued payroll and related expenses. In the first nine months of 2017, changes in operating assets and liabilities resulted in a net use of cash of \$1,286,289 which was primarily due to the buildup of inventories to support rising sales and to provide economic order quantity savings on orders, increases in accounts receivable driven by the higher shipment level during the last couple weeks of September, new product D600 software development costs which are expected to be amortized over the life of D600 starting from Q4 2017, and product certification costs which are capitalized and amortized over the shorter of the certification period or the useful life of the product. The uses of cash were partially offset by increases of the inventory levels in our distribution channel and a deposit collected from a customer who placed an order for a legacy product.

Index

In the first nine months of 2018 and 2017, we invested \$389,000 and \$196,000, respectively, in manufacturing tooling for new products, software development and purchases of computer hardware.

Net cash used in financing activities was \$2.3 million in the first nine months of 2018, compared to net cash provided of \$263,000 in the comparable period a year ago. Financing activities in 2018 consisted primarily of the \$5.0 million use of cash related to repurchase of company stock, partially offset by net \$958,000 borrowed on our term loan, net \$1.53 million borrowed on our bank lines of credit, and \$279,000 proceeds from the exercise of stock options. Financing activities in the first nine months of 2017 consisted primarily of the proceeds from the exercise of stock options.

**Contractual Obligations**

Our contractual cash obligations at September 30, 2018 are outlined in the table below:

	Total	Payments Due by Period			
		Less than 1 year	1 to 3 years	4 to 5 years	More than 5 years
Contractual Obligations					
Unconditional purchase obligations with contract manufacturers	\$5,139,000	\$4,371,000	\$768,000	\$—	\$ —
Operating leases	1,802,000	456,000	966,000	380,000	—
Capital leases	30,000	17,000	13,000	—	—
Total contractual obligations	\$6,971,000	\$4,844,000	\$1,747,000	\$380,000	\$ —

**Off-Balance Sheet Arrangements**

As of September 30, 2018, we have no off-balance sheet arrangements as defined in Item 303 of Regulation S-K.





Index

Item 3. Quantitative and Qualitative Disclosures about Market Risk

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our bank term loan and credit line facilities. Amounts outstanding under the term loan bear interest at lender's prime rate (minimum of 4.25%) plus 1.75%. Our bank credit line facilities of up to \$2.5 million have variable interest rates based upon the lender's prime rate (minimum of 4.25%) plus 0.75%, for both the domestic line (up to \$2.0 million) and the international line (up to \$0.5 million). Accordingly, interest rate increases could increase our interest expense on outstanding term loan and credit line balances. Based on a sensitivity analysis during the three months ended September 30, 2018, an increase of 1% in the interest rate would have increased our second quarter borrowing costs by approximately \$4,000.

**Foreign Currency Risk**

A substantial majority of our revenue, expense and purchasing activities are transacted in U.S. dollars. However, we require our European distributors to purchase our products in Euros and we pay the expenses of our European employees in Euros and British pounds. We may enter into selected future purchase commitments with foreign suppliers that may be paid in the local currency of the supplier. We hedge a significant portion of our European receivables balance denominated in Euros to reduce the foreign currency risk associated with these assets, and we have not been subject to significant losses from material foreign currency fluctuations. Based on a sensitivity analysis of our net foreign currency denominated assets and expenses at the beginning, during and at the end of the quarter ended September 30, 2018, an adverse change of 10% in exchange rates would have resulted in a decrease in our net income for the third quarter of 2018 of approximately \$33,200 if left unprotected. For the third quarter of 2018, the total net adjustment for the effects of changes in foreign currency on cash balances, collections, payables, and derivatives used to hedge foreign currency risks, was a net loss of \$1,500. We will continue to monitor, assess, and mitigate through hedging activities, our risks related to foreign currency fluctuations.



Index

**Item 4. Controls and Procedures**

*Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures*

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting*

There was no change in our internal control over financial reporting that occurred during the period covered by the last fiscal quarter ended September 30, 2018 and this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Index

**PART II**

**Item 1A. Risk Factors**

*The risks described in this Quarterly Report on Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and operating results.*

**We may not maintain ongoing profitability.**

We have been unprofitable in the past three quarters. To maintain ongoing profitability, we must accomplish numerous objectives, including continued growth in our business, ongoing support to registered developers whose applications support the use of our data capture products, and the development of successful new products. We cannot foresee with any certainty whether we will be able to achieve these objectives in the future. Accordingly, we may not generate sufficient net revenue or manage our expenses sufficiently to maintain ongoing profitability. If we cannot maintain ongoing profitability, we will not be able to support our operations from positive cash flows, and we would use our existing cash to support operating losses. If we are unable to secure the necessary capital to replace that cash, we may need to suspend some or all of our current operations.

**We may require additional capital in the future, but that capital may not be available on reasonable terms, if at all, or on terms that would not cause substantial dilution to investors' stock holdings.**

We may need to raise capital to fund our growth or operating losses in future periods. Our forecasts are highly dependent on factors beyond our control, including market acceptance of our products and delays in deployments by businesses of applications that use our data capture products. Even if we maintain profitable operating levels, we may need to raise capital to provide sufficient working capital to fund our growth. If capital requirements vary materially from those currently planned, we may require additional capital sooner than expected. There can be no assurance that such capital will be available in sufficient amounts or on terms acceptable to us, if at all.

**If application developers are not successful in their efforts to develop, market and sell their applications into which our software and products are incorporated, we may not achieve our sales projections.**

We are dependent upon application developers to integrate our scanning and software products into their applications designed for mobile workers using smartphones, tablets and mobile computers, and to successfully market and sell those application products and solutions into the marketplace. We focus on serving the needs of application developers as sales of our data capture products are application driven. However, these developers may take considerable time to complete development of their applications, may experience delays in their development timelines, may develop competing applications, may be unsuccessful in marketing and selling their application products and solutions to customers, or may experience delays in customer deployments and implementations, which would adversely affect our ability to achieve our revenue projections.

Index

**Failure to maintain effective internal controls could have a material adverse effect on our business, operating results and stock price.**

We have evaluated and will continue to evaluate our internal control procedures to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act, which requires an annual management assessment of the design and effectiveness of our internal control over financial reporting. If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. If we cannot provide reliable financial reports or detect and prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.

**Despite security protections, our business records and information system could be hacked by unauthorized personnel**

We protect our business records and information from access by unauthorized personnel. We maintain adequate segregation of duties in safeguarding our assets and related records and monitor our systems to detect any attempts to bypass our controls and procedures which we evaluate and update from time to time. We are aware that unauthorized efforts to access our business records and information system with sophisticated tools could bypass our controls and procedures and we remain alert to that possibility.

**Global economic conditions may have a negative impact on our business and financial condition in ways that we currently cannot predict and may further limit our ability to raise additional funds.**

Global economic conditions may have an impact on our business and our financial condition. We may face significant challenges if global economic growth slows down and conditions in the financial markets worsen. In particular, if these conditions cause our revenues to be materially less than forecast, we may find it necessary to initiate reductions in our expenses and defer product development programs. In addition, our ability to access the capital markets and raise funds required for our operations may be severely restricted at a time when we would like, or need to do so, which could have an adverse effect on our ability to meet our current and future funding requirements and on our flexibility to react to changing economic and business conditions.

Index

**Our quarterly operating results may fluctuate in future periods, which could cause our stock price to decline.**

We expect to experience quarterly fluctuations in operating results in the future. We generally ship orders as received, and as a result we may have little backlog. Quarterly revenues and operating results therefore depend on the volume and timing of orders received during the quarter, which are difficult to forecast. Historically, we have often recognized a substantial portion of our revenue in the last month of the quarter. This subjects us to the risk that even modest delays in orders or in the manufacture of products relating to orders received, may adversely affect our quarterly operating results. Our operating results may also fluctuate due to factors such as:

- the demand for our products;
- the size and timing of customer orders;
- unanticipated delays or problems in our introduction of new products and product enhancements;
- the introduction of new products and product enhancements by our competitors;
- the timing of the introduction and deployments of new applications that work with our products;
- changes in the revenues attributable to royalties and engineering development services;
- product mix;
- timing of software enhancements;
- changes in the level of operating expenses;
- competitive conditions in the industry including competitive pressures resulting in lower average selling prices;
- timing of distributors' shipments to their customers;
- delays in supplies of key components used in the manufacturing of our products, and
- general economic conditions and conditions specific to our customers' industries.

Because we base our staffing and other operating expenses on anticipated revenues, unanticipated declines or delays in the receipt of orders can cause significant variations in operating results from quarter to quarter. As a result of any of the foregoing factors, or a combination, our results of operations in any given quarter may be below the expectations of public market analysts or investors, in which case the market price of our common stock would be adversely affected.

**In order to maintain the availability of our bank lines of credit we must remain in compliance with the covenants as specified under the terms of the credit agreements and the bank may exercise discretion in making advances to us.**

Our credit agreements with our bank requires us to maintain compliance with an asset coverage ratio measured monthly, which requirements increase during the term of the financing agreement. The agreement contains customary affirmative and negative covenants, including covenants that limit or restrict our ability to, among other things, grant liens, make investments, incur indebtedness, merge or consolidate, dispose of assets, make acquisitions, pay dividends or make distributions, repurchase stock, enter into transactions with affiliates and enter into restrictive agreements, in each case subject to customary exceptions for a credit facility of this size and type. The agreement also contains customary events of default including, among others, payment defaults, breaches of covenants, bankruptcy and



insolvency events, cross defaults with certain material indebtedness, judgment defaults, and breaches of representations and warranties. Upon an event of default, our bank may declare all or a portion of our outstanding obligations payable to be immediately due and payable and exercise other rights and remedies provided for under the agreement. During the existence of an event of default, interest on the obligations could be increased. The agreement may be terminated by us or by our bank at any time. Upon such termination, our bank would no longer make advances under the credit agreement and outstanding advances would be repaid as receivables are collected. All advances are at our bank's discretion and our bank is not obligated to make advances.

Index

**Deferred tax assets comprise a significant portion of our assets and are dependent upon future tax profitability to realize the benefits.**

We have recorded deferred tax assets on our balance sheet because we believe that it is more likely than not that we will generate sufficient tax profitability in the future to realize the tax savings our deferred tax assets represent. If we do not achieve and maintain sufficient profitability, the tax savings represented by our deferred tax assets may never be realized and we would need to recognize a loss for those deferred tax assets.

**Goodwill comprises a significant portion of our assets and may be subject to impairment write-downs in future periods which would substantially increase our losses, make it more difficult to achieve profitability, and could cause our stock price to decline.**

We review our goodwill for impairment at least annually as of September 30th, and more often if factors suggest potential impairment. Many factors are considered in evaluating goodwill including our market capitalization, comparable companies within our industry, our estimates of our future performance, and discounted cash flow analysis. Many of these factors are highly subjective and may be negatively impacted by our financial results and market conditions in the future. We may incur goodwill impairment charges in the future and any future write-downs of our goodwill would adversely affect our operating results, make it more difficult to maintain profitability, and as a result the market price of our common stock could be adversely affected.

**We may be unable to manufacture our products because we are dependent on a limited number of qualified suppliers for our components.**

Several of our component parts are produced by one or a limited number of suppliers. Shortages or delays could occur in these essential components due to an interruption of supply or increased demand in the industry. Suppliers may choose to restrict credit terms or require advance payment causing delays in the procurement of essential materials. If we are unable to procure certain component parts, we could be required to reduce our operations while we seek alternative sources for these components, which could have a material adverse effect on our financial results. To the extent that we acquire extra inventory stocks to protect against possible shortages, we would be exposed to additional risks associated with holding inventory, such as obsolescence, excess quantities, or loss.

Index

**If we fail to develop and introduce new products rapidly and successfully, we will not be able to compete effectively, and our ability to generate sufficient revenues will be negatively affected.**

The market for our products is prone to rapidly changing technology, evolving industry standards and short product life cycles. If we are unsuccessful at developing and introducing new products and services on a timely basis that include the latest technologies, conform to the newest standards and that are appealing to end users, we will not be able to compete effectively, and our ability to generate significant revenues will be seriously harmed.

The development of new products and services can be very difficult and requires high levels of innovation. The development process is also lengthy and costly. Short product life cycles for smartphones and tablets expose our products to the risk of obsolescence and require frequent new product upgrades and introductions. We will be unable to introduce new products and services into the market on a timely basis and compete successfully, if we fail to:

- invest significant resources in research and development, sales and marketing, and customer support;
- identify emerging trends, demands and standards in the field of mobile computing products;
  - enhance our products by adding additional features;
  - maintain superior or competitive performance in our products; and
  - anticipate our end users' needs and technological trends accurately.

We cannot be sure that we will have sufficient resources to make adequate investments in research and development or that we will be able to identify trends or make the technological advances necessary to be competitive.

**A significant portion of our revenue currently comes from a limited number of distributors, and any decrease in revenue from these distributors could harm our business.**

A significant portion of our revenue comes from a limited number of distributors. In the first nine months of 2018 and 2017, Ingram Micro Inc., BlueStar, Inc. and ScanSource, Inc. together represented approximately 65% and 73%, respectively, of our worldwide revenues. We expect that a significant portion of our revenue will continue to depend on sales to a limited number of distributors. We do not have long-term commitments from our distributors to carry our products, and any of our distributors may from quarter to quarter comprise a significant concentration of our revenues. Any could choose to stop selling some or all of our products at any time, and each of these companies also carries our competitors' products. If we lose our relationship with any of our significant distributors, we would experience disruption and delays in marketing our products.

**We may not be able to collect receivables from customers who experience financial difficulties.**

Our accounts receivables are derived primarily from distributors. We perform ongoing credit evaluations of our customers' financial conditions but generally require no collateral from our customers. Reserves are maintained for potential credit losses, and such losses have historically been within such reserves. However, many of our customers may be thinly capitalized and may be prone to failure in adverse market conditions. Although our collection history has been good, from time to time a customer may not pay us because of financial difficulty, bankruptcy or liquidation. If global financial conditions have an impact on our customers' ability to pay us in a timely manner, and consequently, we may experience increased difficulty in collecting our accounts receivable, and we may have to increase our reserves in anticipation of increased uncollectible accounts.

Index

**We could face increased competition in the future, which would adversely affect our financial performance.**

The market in which we operate is very competitive. Our future financial performance is contingent on a number of unpredictable factors, including that:

- some of our competitors have greater financial, marketing, and technical resources than we do; we periodically face intense price competition, particularly when our competitors have excess inventories and discount their prices to clear their inventories; and
- certain manufacturers of tablets and mobile phones offer products with built-in functions, such as Bluetooth wireless technology or barcode scanning, that compete with our products.

Increased competition could result in price reductions, fewer customer orders, reduced margins, and loss of market share. Our failure to compete successfully against current or future competitors could harm our business, operating results and financial condition.

**If we do not correctly anticipate demand for our products, our operating results will suffer.**

The demand for our products depends on many factors and is difficult to forecast as we introduce and support more products, and as competition in the markets for our products intensifies. If demand is lower than forecasted levels, we could have excess production resulting in higher inventories of finished products and components, which could lead to write-downs or write-offs of some or all of the excess inventories, and reductions in our cash balances. Lower than forecasted demand could also result in excess manufacturing capacity at our third-party manufacturers and in our failure to meet minimum purchase commitments, each of which may lower our operating results.

If demand increases beyond forecasted levels, we would have to rapidly increase production at our third-party manufacturers. We depend on suppliers to provide additional volumes of components, and suppliers might not be able to increase production rapidly enough to meet unexpected demand. Even if we were able to procure enough components, our third-party manufacturers might not be able to produce enough of our devices to meet our customer demand. In addition, rapid increases in production levels to meet unanticipated demand could result in higher costs for manufacturing and supply of components and other expenses. These higher costs could lower our profit margins. Further, if production is increased rapidly, manufacturing yields could decline, which may also lower operating results.

**We rely primarily on distributors to sell our products, and our sales would suffer if any of these distributors stops selling our products effectively.**

Because we sell our products primarily through distributors, we are subject to risks associated with channel distribution, such as risks related to their inventory levels and support for our products. Our distribution channels may build up inventories in anticipation of growth in their sales. If such growth in their sales does not occur as anticipated, the inventory build-up could contribute to higher levels of product returns. The lack of sales by any one significant participant in our distribution channels could result in excess inventories and adversely affect our operating results and working capital liquidity.

Index

Our agreements with distributors are generally nonexclusive and may be terminated on short notice by them without cause. Our distributors are not within our control, are not obligated to purchase products from us, and may offer competitive lines of products simultaneously. Sales growth is contingent in part on our ability to enter additional distribution relationships and expand our sales channels. We cannot predict whether we will be successful in establishing new distribution relationships, expanding our sales channels or maintaining our existing relationships. A failure to enter new distribution relationships or to expand our sales channels could adversely impact our ability to grow our sales.

We allow our distribution channels to return a portion of their inventory to us for full credit against other purchases. In addition, in the event we reduce our prices, we credit our distributors for the difference between the purchase price of products remaining in their inventory and our reduced price for such products. Actual returns and price protection may adversely affect future operating results and working capital liquidity by reducing our accounts receivable and increasing our inventory balances, particularly since we seek to continually introduce new and enhanced products and are likely to face increasing price competition.

**We depend on alliances and other business relationships with third-parties, and a disruption in these relationships would hinder our ability to develop and sell our products.**

We depend on strategic alliances and business relationships with leading participants in various segments of the mobile applications market to help us develop and market our products. Our strategic partners may revoke their commitment to our products or services at any time in the future or may develop their own competitive products or services. Accordingly, our strategic relationships may not result in sustained business alliances, successful product or service offerings, or the generation of significant revenues. Failure of one or more of such alliances could result in delay or termination of product development projects, failure to win new customers, or loss of confidence by current or potential customers.

We have devoted significant research and development resources to design products to work with a number of operating systems used in mobile devices including Apple (iOS), Google (Android), and Microsoft (Windows). Such design activities have diverted financial and personnel resources from other development projects. These design activities are not undertaken pursuant to any agreement under which Apple, Google or Microsoft is obligated to collaborate or to support the products produced from such collaboration. Consequently, these organizations may terminate their collaborations with us for a variety of reasons, including our failure to meet agreed-upon standards or for reasons beyond our control, such as changing market conditions, increased competition, discontinued product lines, and product obsolescence.

Index

**Our intellectual property and proprietary rights may be insufficient to protect our competitive position.**

Our business depends on our ability to protect our intellectual property. We rely primarily on patent, copyright, trademark, trade secret laws, and other restrictions on disclosure to protect our proprietary technologies. We cannot be sure that these measures will provide meaningful protection for our proprietary technologies and processes. We cannot be sure that any patent issued to us will be sufficient to protect our technology. The failure of any patents to provide protection to our technology would make it easier for our competitors to offer similar products. In connection with our participation in the development of various industry standards, we may be required to license certain of our patents to other parties, including our competitors that develop products based upon the adopted standards.

We also generally enter into confidentiality agreements with our employees, distributors, and strategic partners, and generally control access to our documentation and other proprietary information. Despite these precautions, it may be possible for a third-party to copy or otherwise obtain and use our products, services, or technology without authorization, develop similar technology independently, or design around our patents.

Effective copyright, trademark, and trade secret protection may be unavailable or limited in certain foreign countries.

**We may become subject to claims of intellectual property rights infringement, which could result in substantial liability.**

In the course of operating our business, we may receive claims of intellectual property infringement or otherwise become aware of potentially relevant patents or other intellectual property rights held by other parties. Many of our competitors have large intellectual property portfolios, including patents that may cover technologies that are relevant to our business. In addition, many smaller companies, universities, and individuals have obtained or applied for patents in areas of technology that may relate to our business. The industry is moving towards aggressive assertion, licensing, and litigation of patents and other intellectual property rights.

If we are unable to obtain and maintain licenses on favorable terms for intellectual property rights required for the manufacture, sale, and use of our products, particularly those products which must comply with industry standard protocols and specifications to be commercially viable, our results of operations or financial condition could be adversely impacted.



In addition to disputes relating to the validity or alleged infringement of other parties' rights, we may become involved in disputes relating to our assertion of our own intellectual property rights. Whether we are defending the assertion of intellectual property rights against us or asserting our intellectual property rights against others, intellectual property litigation can be complex, costly, protracted, and highly disruptive to business operations by diverting the attention and energies of management and key technical personnel. Plaintiffs in intellectual property cases often seek injunctive relief, and the measures of damages in intellectual property litigation are complex and often subjective or uncertain. Thus, any adverse determinations in this type of litigation could subject us to significant liabilities and costs.

Index

**New industry standards may require us to redesign our products, which could substantially increase our operating expenses.**

Standards for the form and functionality of our products are established by standards committees. These independent committees establish standards, which evolve and change over time, for different categories of our products. We must continue to identify and ensure compliance with evolving industry standards so that our products are interoperable, and we remain competitive. Unanticipated changes in industry standards could render our products incompatible with products developed by major hardware manufacturers and software developers. Should any major changes, even if anticipated, occur, we would be required to invest significant time and resources to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, we would miss opportunities to sell our products for use with new hardware components from mobile computer manufacturers and OEMs, thus affecting our business.

**Undetected flaws and defects in our products may disrupt product sales and result in expensive and time-consuming remedial action.**

Our hardware and software products may contain undetected flaws, which may not be discovered until customers have used the products. From time to time, we may temporarily suspend or delay shipments or divert development resources from other projects to correct a particular product deficiency. Efforts to identify and correct errors and make design changes may be expensive and time consuming. Failure to discover product deficiencies in the future could delay product introductions or shipments, require us to recall previously shipped products to make design modifications, or cause unfavorable publicity, any of which could adversely affect our business and operating results.

**The loss of one or more of our senior personnel could harm our existing business.**

A number of our officers and senior managers have been employed for more than twenty years by us, including our President, Chief Financial Officer, Vice President of Operations and Vice President of Engineering/Chief Technical Officer. Our future success will depend upon the continued service of key officers and senior managers. Competition for officers and senior managers is intense, and there can be no assurance that we will be able to retain our existing senior personnel. The loss of one or more of our officers or key senior managers could adversely affect our ability to compete.

**The expensing of options will continue to reduce our operating results such that we may find it necessary to change our business practices to attract and retain employees.**

Historically, we have used stock options as a key component of our employee compensation packages. We believe that stock options provide an incentive to our employees to maximize long-term stockholder value and, through the use of vesting, encourage valued employees to remain with us. The expensing of employee stock options adversely affects our net income and earnings per share, will continue to adversely affect future quarters, and will make profitability harder to achieve. In addition, we may decide in response to the effects of expensing stock options on our operating results to reduce the number of stock options granted to employees or to grant options to fewer employees. This could adversely affect our ability to retain existing employees and attract qualified candidates and also could increase the cash compensation we would have to pay to them.

Index

**If we are unable to attract and retain highly skilled sales and marketing and product development personnel, our ability to develop and market new products and product enhancements will be adversely affected.**

We believe our ability to achieve increased revenues and to develop successful new products and product enhancements will depend in part upon our ability to attract and retain highly skilled sales and marketing and product development personnel. Our products involve a number of new and evolving technologies, and we frequently need to apply these technologies to the unique requirements of mobile products. Our personnel must be familiar with both the technologies we support and the unique requirements of the products to which our products connect. Competition for such personnel is intense, and we may not be able to attract and retain such key personnel. In addition, our ability to hire and retain such key personnel will depend upon our ability to raise capital or achieve increased revenue levels to fund the costs associated with such key personnel. Failure to attract and retain such key personnel will adversely affect our ability to develop and market new products and product enhancements.

**Our operating results could be harmed by economic, political, regulatory and other risks associated with export sales.**

Our operating results are subject to the risks inherent in export sales, including:

- longer payment cycles;
- unexpected changes in regulatory requirements, import and export restrictions and tariffs;
  - difficulties in managing foreign operations;
  - the burdens of complying with a variety of foreign laws;
  - greater difficulty or delay in accounts receivable collection;
  - potentially adverse tax consequences; and
  - political and economic instability.

Our export sales are primarily denominated in Euros for our sales to European distributors. Accordingly, an increase in the value of the United States dollar relative to Euros could make our products more expensive and therefore potentially less competitive in European market. Declines in the value of the Euro relative to the United States dollar may result in foreign currency losses relating to collection of Euro denominated receivables if left unhedged.

Index

**Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, and other events beyond our control.**

Our corporate headquarters is located near an earthquake fault. The potential impact of a major earthquake on our facilities, infrastructure, and overall business is unknown. Additionally, we may experience electrical power blackouts or natural disasters that could interrupt our business. Should a disaster be widespread, such as a major earthquake, or result in the loss of key personnel, we may not be able to implement our disaster recovery plan in a timely manner. Any losses or damages incurred by us as a result of these events could have a material adverse effect on our business.

**The sale of a substantial number of shares of our common stock could cause the market price of our common stock to decline.**

Sales of a substantial number of shares of our common stock in the public market could adversely affect the market price for our common stock. The market price of our common stock could also decline if one or more of our significant stockholders decided for any reason to sell substantial amounts of our common stock in the public market.

As of November 7, 2018, we had 5,883,109 shares of common stock outstanding. Substantially all of these shares are freely tradable in the public market, either without restriction or subject, in some cases, only to S-3 prospectus delivery requirements and, in other cases, only to manner of sale, volume, and notice requirements of Rule 144 under the Securities Act.

As of November 7, 2018, we had 2,374,124 shares of common stock subject to outstanding options under our stock option plans, and 116,703 shares of common stock were available for future issuance under the plans. We have registered the shares of common stock subject to outstanding options and reserved for issuance under our stock option plans. Accordingly, the shares of common stock underlying vested options will be eligible for resale in the public market as soon as the options are exercised.

**Volatility in the trading price of our Common Stock could negatively impact the price of our Common Stock.**

During the period from January 1, 2017 through November 7, 2018, our common stock price fluctuated between a high of \$4.90 and a low of \$1.67. We have experienced low trading volumes in our stock, and thus relatively small purchases and sales can have a significant effect on our stock price. The trading price of our common stock could be subject to wide fluctuations in response to many factors, some of which are beyond our control, including general

economic conditions and the outlook of securities analysts and investors on our industry. In addition, the stock markets in general, and the markets for high technology stocks in particular, have experienced high volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

Index

**Item 6. Exhibits**

Exhibits

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Index

**SIGNATURES**

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

SOCKET MOBILE, INC.

Registrant

Date: November 14, 2018 /s/ Kevin J. Mills  
Kevin J. Mills  
President and Chief Executive Officer  
(Duly Authorized Officer and Principal Executive Officer)

Date: November 14,  
2018 /s/ David W. Dunlap  
David W. Dunlap  
Vice President of Finance and Administration and Chief Financial Officer (Duly Authorized  
Officer and Principal Financial and Accounting Officer)





Index

**Index to Exhibits**

Exhibit  
Number Description

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Index