

MobileSmith, Inc.  
Form 10-Q  
November 13, 2017

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2017

OR

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

Commission File Number: 001-32634

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MOBILESMITH, INC.  
(Exact name of registrant as specified in its charter)

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Delaware 95-4439334  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

5400 Trinity Road, Suite 208 27607  
Raleigh, North Carolina  
(Address of principal executive offices)(Zip Code)

(855) 516-2413  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

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

As of November 13, 2017, there were 24,722,647 shares of the registrant's common stock, par value \$0.001 per share, outstanding.



MOBILESMITH, INC.

FORM 10-Q

For the Quarterly Period Ended September 30, 2017

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PART I – FINANCIAL INFORMATION  
MOBILESMITH, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

## ASSETS

	September 30,	December 31,
	2017	2016
	(unaudited)	
Current Assets		
Cash and Cash Equivalents	\$1,443,262	\$548,146
Restricted Cash	61,713	116,577
Trade Accounts Receivable, Less Allowance for Doubtful Accounts of \$12,500 and \$0, Respectively	267,939	273,091
Prepaid Expenses and Other Current Assets	49,549	64,642
Total Current Assets	1,822,463	1,002,456
Property and Equipment, Net	81,647	104,129
Capitalized Software, Net	195,903	274,833
Intangible Assets, Net	24,469	37,593
Total Other Assets	302,019	416,555
Total Assets	\$2,124,482	\$1,419,011
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current Liabilities		
Trade Accounts Payable	\$84,059	\$43,518
Accrued Expenses	178,673	193,836
Accrued Interest	881,242	455,269
Capital Lease Obligations	36,624	36,950
Deferred Revenue	1,239,165	1,404,951
Bank Loan	5,000,000	-
Total Current Liabilities	7,419,763	2,134,524
Long-Term Liabilities		
Bank Loan	-	5,000,000
Convertible Notes Payable, Related Parties, Net of Discount	43,788,609	39,655,579
Convertible Notes Payable, Net of Discount	680,640	680,640
Capital Lease Obligations	36,733	63,834
Deferred Rent	30,839	42,189
Total Long-Term Liabilities	44,536,821	45,442,242

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Total Liabilities	51,956,584	47,576,766
Commitments and Contingencies (Note 3)		
Stockholders' Deficit		
Preferred Stock, \$0.001 Par Value, 5,000,000 Shares Authorized, No Shares Issued and Outstanding at September 30, 2017 and December 31, 2016	-	-
Common Stock, \$0.001 Par Value, 100,000,000 Shares Authorized At September 30, 2017 and December 31, 2016; 19,827,542 Shares Issued and Outstanding at September 30, 2017 and December 31, 2016	19,828	19,828
Additional Paid-in Capital	98,650,709	98,245,063
Accumulated Deficit	(148,502,639)	(144,422,646)
Total Stockholders' Deficit	(49,832,102)	(46,157,755)
Total Liabilities and Stockholders' Deficit	\$2,124,482	\$1,419,011

The accompanying notes are an integral part of these condensed consolidated financial statements.





MOBILESMITH, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2017	2016	2017	2016
REVENUES:				
Subscription and Support	\$1,886,344	\$415,166	\$2,932,687	\$1,380,465
Professional Services and Other	-	-	-	4,154
Total Revenue	1,886,344	415,166	2,932,687	1,384,619
COST OF REVENUES:				
Subscription and Support	147,535	138,175	431,457	346,544
Professional Services and Other	-	11,418	29,304	67,660
Total Cost of Revenue	147,535	149,593	460,761	414,204
GROSS PROFIT	1,738,809	265,573	2,471,926	970,415
OPERATING EXPENSES:				
Sales and Marketing	299,559	288,129	865,181	849,303
Research and Development	406,113	446,490	1,295,647	1,253,889
General and Administrative	367,342	257,615	1,165,708	1,009,976
Total Operating Expenses	1,073,014	992,234	3,326,536	3,113,168
INCOME (LOSS) FROM OPERATIONS	665,795	(726,661)	(854,610)	(2,142,753)
OTHER INCOME (EXPENSE):				
Other Income	365	153,918	1,549	165,486
Interest Expense, Net	(1,104,318)	(997,730)	(3,226,932)	(3,701,073)
Total Other Expense	(1,103,953)	(843,812)	(3,225,383)	(3,535,587)
NET LOSS	\$(438,158)	\$(1,570,473)	\$(4,079,993)	\$(5,678,340)
NET LOSS PER COMMON SHARE:				
Basic and Fully Diluted	\$(0.02)	\$(0.08)	\$(0.21)	\$(0.29)
WEIGHTED-AVERAGE NUMBER OF SHARES USED IN COMPUTING NET LOSS PER COMMON SHARE:				
Basic and Fully Diluted	19,827,542	19,827,542	19,827,542	19,827,542

The accompanying notes are an integral part of these condensed consolidated financial statements.



MOBILESMITH, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (unaudited)

	Nine Months Ended	
	September 30,	September 30,
	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Loss	\$(4,079,993)	\$(5,678,340)
Adjustments to Reconcile Net Loss to Net Cash Used in Operating Activities:		
Depreciation and Amortization	122,873	123,324
Bad Debt Expense	12,500	33,300
Amortization of Debt Discount	486,527	1,248,736
Share Based Compensation	327,149	63,309
Impairment of Long Lived Assets	-	8,356
Changes in Assets and Liabilities:		
Accounts Receivable	(7,348)	(81,805)
Prepaid Expenses and Other Assets	15,093	9,563
Accounts Payable	40,541	13,633
Deferred Revenue	(165,786)	353,595
Accrued and Other Expenses	399,462	(33,583)
Net Cash Used in Operating Activities	(2,848,982)	(3,939,912)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Payments to Acquire Property, Plant and Equipment	(8,339)	(26,483)
Net Cash Used in Investing Activities	(8,339)	(26,483)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Restricted Cash Used to Pay Interest Expense	166,812	166,610
Deposit of Cash to Restricted Account	(111,948)	(114,765)
Proceeds From Issuance of Short Term Loan from Related Party	150,000	-
Repayments of Short Term Loan from Related Party	(150,000)	-
Proceeds From Issuance of Long Term Debt	3,725,000	3,750,000
Repayments of Debt Borrowings	(27,427)	(22,911)
Net Cash Provided by Financing Activities	3,752,437	3,778,934
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>895,116</b>	<b>(187,461)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>548,146</b>	<b>580,220</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$1,443,262</b>	<b>\$392,759</b>

Supplemental Disclosures of Cash Flow Information:

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Cash Paid During the Period for Interest	\$2,314,434	\$2,397,504
Non-Cash Investing and Financing Activities		
The Company Recorded Debt Discount Associated with Beneficial Conversion Feature	\$78,497	\$533,216
Financed Purchase of a Vehicle	-	\$18,365

The accompanying notes are an integral part of these condensed consolidated financial statements.



MOBILESMITH, INC.  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT  
 FOR THE PERIOD ENDED SEPTEMBER 30, 2017  
 (unaudited)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Totals
	\$0.001				
	Shares	Par Value			
BALANCES, DECEMBER 31, 2016	19,827,542	\$19,828	\$98,245,063	\$(144,422,646)	\$(46,157,755)
Equity-Based Compensation	-	-	327,149	-	327,149
Beneficial Conversion Feature					
Recorded as a Result of Issuance of	-	-	78,497	-	78,497
Convertible Debt					
Net Loss	-	-	-	(4,079,993)	(4,079,993)
BALANCES, SEPTEMBER 30, 2017	19,827,542	\$19,828	\$98,650,709	\$(148,502,639)	\$(49,832,102)

The accompanying notes are an integral part of these condensed consolidated financial statements.





MOBILESMITH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Quarterly Period Ended September 30, 2017

(unaudited)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

MobileSmith, Inc. (referred to herein as the “Company,” “us,” “we,” or “our”) was incorporated as Smart Online, Inc. in the State of Delaware in 1993. The Company changed its name to MobileSmith, Inc. effective July 1, 2013.

The Company develops solutions for healthcare industry that focus on improvements in delivery of healthcare by means of mobile technology. The Company’s flagship product is the MobileSmith® Platform (the “Platform”). The Platform is an innovative hosted set of tools that enables organizations to rapidly create, deploy, and manage custom, native smartphone and tablet apps specific to healthcare industry deliverable across iOS and Android mobile platforms without writing a single line of code. The Platform has applications in other industries and has been successfully deployed in retail and real estate operations.

These condensed consolidated financial statements include accounts of the Company and its wholly owned subsidiary, which was created to explore the concept of a consumer targeted mobile app development platform. From time to time, the Company may create additional wholly-owned subsidiaries in order to test various new services as a part of its research and development process. The subsidiary has not had material activity in 2017.

The Company’s principal products and services include:

- Subscription to its Software as a Service (“SaaS”) cloud based mobile app development platform to customers who design and build their own apps;

- Managed services for custom mobile application design, development and implementation;

- Mobile application marketing services; and

- Mobile strategy implementation consulting.

The Company prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its audited annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In management’s opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its financial position, results of operations, cash flows, and stockholders’ deficit as of September 30, 2017. The Company’s interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These condensed consolidated financial statements and accompanying notes should be read in conjunction with the audited annual consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016 on file with the SEC (the “Annual Report”).

Except as otherwise noted, there have been no material changes to the Company’s significant accounting policies as compared to the significant accounting policies described in the Annual Report. The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. During the nine months ended September 30, 2017 and 2016, the Company incurred net losses as well as negative cash flows from operations. These factors raise

substantial doubt about the Company's ability to continue as a going concern. The accompanying condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts or classification of liabilities that might be necessary should the Company be unable to continue as a going concern.



## Recently Issued Accounting Pronouncements

The Company evaluates new significant accounting pronouncements at each reporting period. For the period ended September 30, 2017, the Company did not adopt any new pronouncement that had or is expected to have a material effect on the Company's presentation of its condensed consolidated financial statements.

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-9 Revenue from Contracts with Customers (Topic 606). This guidance requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance is effective for annual reporting periods beginning after December 15, 2017, and early adoption is permitted. Originally the Company planned to adopt the standard early. During the current period the Company concluded that costs of early adoption outweigh the anticipated benefits during the upcoming year and concluded that the adoption will take place with the period beginning on January 1, 2018, in compliance with the issued standards. The Company has commenced work to assess the impact of the new revenue standard on its principal revenue streams. The Company has not made a determination on the impact to its consolidated financial statements. The Company is implementing changes to its accounting processes, internal controls and disclosures to support the new accounting.

## 2. DEBT

The table below summarizes the Company's debt outstanding at September 30, 2017 and December 31, 2016:

Debt Description	September 30, December 31,		Maturity	Rate
	2017	2016		
Comerica Bank Loan and Security Agreement	\$5,000,000	\$5,000,000	June 2018	4.85%
Capital lease obligations - Noteholder lease	51,583	69,717	August 2019	8.00%
Capital lease obligations - office furniture and other equipment	7,248	14,044	August 2018	9.80%
Capital lease obligations - vehicle	14,526	17,023	July 2021	5.59%
Convertible notes - related parties, net of discount of \$760,622 and \$1,168,652, respectively	43,788,609	39,655,579	November 2018	8.00%
Convertible notes, net of discount of \$50,129	680,640	680,640	November 2018	8.00%
Total debt	49,542,606	45,437,003		
Less: current portion of long term debt				
Capital lease obligations	36,624	36,950		
Comerica Bank Loan and Security Agreement	5,000,000	-		
Total current portion of long term debt	5,036,624	36,950		
Debt - long term	\$44,505,982	\$45,400,053		

Convertible Notes

During the nine months ended September 30, 2017, the Company privately placed \$3,725,000 in principal amount of additional unsecured Convertible Subordinated Notes (the “2014 NPA Notes”) to Union Bancaire Privée (“UBP”) under its existing unsecured Convertible Subordinated Note Purchase Agreement dated December 10, 2014 (the “2014 NPA”). The 2014 NPA Notes are convertible by the holder into shares of the Company’s common stock, par value \$0.001 per share (the “Common Stock”) at a per share conversion price of \$1.43.

The table below summarizes convertible notes issued as of September 30, 2017 by type:

Convertible Notes Type:	Balance
2007 NPA notes, net of discount	\$30,020,339
2014 NPA notes, net of discount	14,448,910
Total convertible notes, net of discount	\$44,469,249

Comerica LSA

The Company has an outstanding Loan and Security Agreement with Comerica Bank dated June 9, 2014 in the amount of \$5,000,000, with an extended maturity date of June 6, 2018.



### 3. COMMITMENTS AND CONTINGENCIES

#### Aggregate future lease commitments

The Company leases computers, office equipment, office furniture and a company vehicle under capital lease agreements that expire through July 2021. Total amount financed under these capital leases at September 30, 2017 was \$73,357. This obligation is included within the Company's total debt.

The table below summarizes Company's future obligations under its capital leases:

Year:

2017	\$10,869
2018	38,345
2019	23,631
2020	4,219
Thereafter	2,461
	79,525
Less amount representing interest	(6,168)
Capital lease obligations	\$73,357

The Company leases its office space in Raleigh, North Carolina pursuant to a lease with an initial term that expires in March 2019. The lease contains an option to renew for two additional three-year lease terms.

The table below summarizes the Company's future obligation under its office lease:

Year:

2017	\$42,524
2018	172,418
2019	44,082
Total	\$259,024





## Legal Proceedings

From time to time, the Company may be subject to routine litigation, claims or disputes in the ordinary course of business. The Company defends itself vigorously in all such matters. In the opinion of management, no pending or known threatened claims, actions or proceedings against the Company are expected to have a material adverse effect on its financial position, results of operations or cash flows. However, the Company cannot predict with certainty the outcome or effect of any such litigation or investigatory matters or any other pending litigations or claims. There can be no assurance as to the ultimate outcome of any such lawsuits and investigations. The Company will record a liability when it believes that it is both probable that a loss has been incurred and the amount can be reasonably estimated. The Company periodically evaluates developments in its legal matters that could affect the amount of liability that it has previously accrued, if any, and makes adjustments as appropriate. Significant judgment is required to determine both the likelihood of there being, and the estimated amount of, a loss related to such matters, and the Company's judgment may be incorrect. The outcome of any proceeding is not determinable in advance. Until the final resolution of any such matters that the Company may be required to accrue for, there may be an exposure to loss in excess of the amount accrued, and such amounts could be material.

## 4. EQUITY AND EQUITY BASED COMPENSATION

As of September 30, 2017, options to purchase 2,164,006 shares of Common Stock were granted under 2016 Equity Compensation Plan, in addition to 172,406 options granted under previous plans.

The following is a summary of the stock option activity for the nine months ended September 30, 2017:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, December 31, 2016	2,184,160	\$1.48		
Cancelled	(185,894)	1.52		
Issued	338,146	1.40		
Outstanding, September 30, 2017	2,336,412	\$1.47	4.10	\$90,445
Vested and exercisable, September 30, 2017	834,527	\$1.50	3.25	\$52,146

Aggregate intrinsic value represents the difference between the closing price of the Company's common stock at September 30, 2017 and the exercise price of outstanding, in-the-money stock options. The closing price of the common stock at September 30, 2017, as reported on the OTCQB Venture Marketplace, was \$1.50 per share.

At September 30, 2017, \$1,078,227 unvested expense has yet to be recorded related to outstanding stock options.

#### 5. MAJOR CUSTOMERS AND CONCENTRATION

For the nine months ended September 30, 2017, one major customer accounted for 54% of total revenues and three customers accounted for 84% of the accounts receivable balance. For the nine months ended September 30, 2016, one major customer accounted for 16% of total revenues and three customers accounted for 67% of the accounts receivable balance.

#### 6. SUBSEQUENT EVENTS

On October 24, 2017 the Company issued a total of 4,895,105 shares of its common stock to UBP upon UBP's conversion of \$7 million in principal amount of 2007 NPA notes.



## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Information set forth in this Quarterly Report on Form 10-Q contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act") and other laws. Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our plan to build our business and the related expenses, our anticipated growth, trends in our business, our ability to continue as a going concern, and the sufficiency of our capital resources including funds that we may be able to raise under our convertible note facility, our ability to raise financing from other sources and/or ability to defer expenditures, the impact of the liens on our assets securing amounts owed to third parties, expectation regarding competitors as more and larger companies attempt to market products/services competitive to our company, market acceptance of our new product offerings, including updates to our Platform, rate of new user subscriptions, market penetration of our products and expectations regarding our revenues and expense, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as "expect," "anticipate," "project," "intend," "plan," "estimate," variations of such words, and similar expressions also are intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are directed to risks and uncertainties identified under Part I, Item 1A, "Risk Factors," in the Annual Report on Form 10-K for the year ended December 31, 2016 and our subsequent periodic reports filed with the SEC for factors that may cause actual results to be different than those expressed in these forward-looking statements. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

The following discussion is designed to provide a better understanding of our unaudited condensed consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance, and a summary of our operating results. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the audited annual consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Annual Report. Historical results and percentage relationships among any amounts in the condensed consolidated financial statements are not necessarily indicative of trends in operating results for any future periods.

### Overview

We develop and market healthcare industry solutions designed to improve delivery of healthcare by means of mobile technology. Our software-as-a-service ("SaaS") platform and related services provide a catalog of vetted mobile app tools that can be rapidly customized and implemented by healthcare organizations with goals of addressing many key pain points of the industry, including preventable readmissions, adherence to treatment plans, management of chronic conditions. Our flagship product is the MobileSmith® Platform (the "Platform"). Platform related services often include data integration, training and integration of third party services. We also provide consulting services, which include assistance with design and implementation of mobile strategy, implementation of mobile marketing strategy and the development of mobile apps. Revenue from such services is included in the Professional Services and Other Revenue line of our Statement of Operations. Delivery of Professional Services requires allocation of a portion of our research and development efforts into Cost of Revenue.

In our business model – the customers acquire access to the Platform through user subscription agreements and are able to obtain control of mobile app production. We often refer to our business model as platform-as-a-service ("PaaS"), because we not only offer cloud software to create mobile apps, we offer infrastructure to host the newly created mobile apps and back-office tools to manage those apps. Our Platform is a truly comprehensive offering and thus

more accurately described by the PaaS model. In the industry and this report terms SaaS and PaaS may be used interchangeably as common reference to cloud computing model.

Our business model allows for creation and management of any desired number of apps by our customers for a monthly subscription fee. The on-demand PaaS model developed using multi-tenant architecture enables end users to visit a website and use the PaaS applications, all via a web browser, with no installation, no special information technology knowledge and no maintenance. The PaaS application is transformed into a service that can be used anytime and anywhere by the end user. Multi-tenant PaaS applications also permit us to add needed functionality to our applications in one location for the benefit of all end users. This capability allows us to provide upgrades universally.

During 2014, for the first time we installed our Platform in a local or a private cloud configuration for one of our government clients. Our Platform was safely placed behind the firewalls of a government department which would allow the organization to create and manage multiple mobile apps with targeted functionality for targeted audiences without going outside of the secure setting.

### Target Market and Sales Channels

We identified several trends that are affecting our target market:

Mobile devices have transformed the way end-users interact with each other, and allow for new efficiencies for business to structure both customer and employee interactions;

Technology departments cannot keep up with the demand for the business transforming apps required by both operational business units and marketing departments;

Non-programmers have become accustomed to solving business problems with do-it-yourself (DIY) software technologies, such as website building, business process management, customer relationship management and others.

We believe that the do-it-yourself model for creation and management of apps will become a cost effective solution for enterprise clients who have an ever increasing need to interact with their customers and employees through mobile devices. Single apps may reach their limits of usability very quickly, if made complex. The Platform provides the subscriber with the capacity to create multiple, customized non-template apps with designated functionalities and specific designs without incurring additional costs.

During 2017 we concluded that we have amassed significant expertise providing mobile app based solutions to healthcare industry and refocused our efforts predominantly on the healthcare and healthcare related industry going forward. We will continue targeting other industries, if solutions for those industries are based on our core expertise in healthcare. Our strategy includes engagement of federal and state governments, who are major players in the delivery of healthcare indirectly through Medicare and Medicaid systems and directly by providing healthcare to nation's active military and its veterans through a Veterans Affairs system. We will continue working with our government clients with a goal of making our return on investment based solutions available in the public center.



## RESULTS OF OPERATIONS

Comparison of the Three Months Ended September 30, 2017 (the "2017 Period") to the Three Months Ended September 30, 2016 (the "2016 Period").

	Three Months Ended September 30,		Increase (Decrease)	
	2017	2016	\$	%
Revenue	1,886,344	415,166	1,471,178	354%
Cost of Revenue	147,535	149,593	(2,058)	(1%)
Gross Profit	1,738,809	265,573	1,473,236	555%
Sales and Marketing	299,559	288,129	11,430	4%
Research and Development	406,113	446,490	(40,377)	(9%)
General and Administrative	367,342	257,615	109,727	43%
Interest Expense	1,104,318	997,730	106,588	11%

Revenue increased by \$1,471,178 or 354%. The increase in revenues is primarily attributable to the recognition and recording of previously deferred revenues. Our revenues were previously impacted by one significant contract for which revenue recognition until the 2017 Period had been deferred in compliance with United States Generally Accepted Accounting Principles ("US GAAP") revenue recognition requirements for sale of software products and services. Throughout 2017 revenue recognition criteria have been met and therefore, the Company commenced related revenue recognition in accordance with our revenue recognition policy.

Cost of Revenue decreased by \$2,058 or (1%), but overall Cost of Revenue was comparable between two periods. Period to period fluctuations take place due to composition of Customer Success team deliverables and services component of these deliverables.

Gross Profit increased by \$1,473,236 or 555% and is primarily attributable to commencement during year 2017 of revenue recognition on a major contract as referred to above. Associated costs of delivery have been incurred and accrued in previous periods.

Sales and Marketing expense increased by \$11,430 or 4%. Increase of approximately \$40,000 is attributable to an increase in compensation due to the expansion of our sales team and increase in commission expense related to an increase in contract bookings and collections in the 2017 Period in comparison to 2016 Period. Increase in sales compensation expense is offset by a decrease in volume of marketing campaigns as we re-evaluated our key marketing activities and strategy in the 2017 Period.

Research and Development expense decreased by \$40,377 or (9%). This decrease is attributable to a \$34,000 decrease in payroll and related expenses and \$25,000 decrease in recruiting expense. These decreases were partially offset by increase in employee stock based compensation expense.

General and Administrative expense increased by \$109,727 or 43%. Such increase is primarily attributable to increase in employee stock based compensation expense of approximately \$70,000 and increase in bad debt expenses of \$66,000, offset by decreases in legal and compliance expenses, infrastructure costs and travel expenses.

Interest Expense increased by \$106,588 or 11%. Such increase is mostly attributable to an increase in the face value of our convertible debt and increase in variable interest rate on our bank loan.





Comparison of the Nine Months Ended September 30, 2017 (the “2017 Period”) to the Nine Months Ended September 30, 2016 (the “2016 Period”).

	Nine Months Ended September 30,		Increase (Decrease)	
	2017	2016	\$	%
Revenue	2,932,687	1,384,619	1,548,068	112%
Cost of Revenue	460,761	414,204	46,557	11%
Gross Profit	2,471,926	970,415	1,501,511	155%
Sales and Marketing	865,181	849,303	15,878	2%
Research and Development	1,295,647	1,253,889	41,758	3%
General and Administrative	1,165,708	1,009,976	155,732	15%
Interest Expense	3,226,932	3,701,073	(474,141)	(13%)

Revenue increased by \$1,548,068 or 112%. The increase in revenues is attributable to the recognition of previously deferred revenues. Our revenues were previously impacted by one significant contract for which revenue recognition had been deferred in compliance with United States Generally Accepted Accounting Principles ("US GAAP") revenue recognition requirements for sale of software products and services. During the 2017 Period, revenue recognition criteria on that contract have been met and approximately \$1.6 million of revenue has been recognized in accordance with our revenue recognition policy.

Cost of Revenue increased by \$46,557 or 11%. Such increase is attributable to the growth of our Customer Success team as a result of realigning our workforce to deliver professional services in mobile app strategy and design.

Gross Profit increased by \$1,501,511 or 155%. Gross Profit was positively impacted by the revenue recognition from the one significant customer contract referred to above for which revenue recognition commenced in 2017 Period, as described above.

Sales and Marketing expense increased by \$15,878 or 2%. Sales and marketing team compensation increased by approximately \$91,000 mostly as a result of increase in salaries of our sales team and commission expense related to increase in contract bookings and collections in 2017 Period in comparison to 2016 Period. Increase in commission expense was offset by overall decrease in marketing spending on campaigns and tradeshows as we continue to adjust our sales and marketing activities to conform to our overall sales and marketing goals.

Research and Development expense increased by \$41,758 or 3%. This increase is attributable to a decrease in amount of our research and development team's effort that was allocated to cost of revenue in the 2017 Period in comparison

to 2016 Period. Certain service components of our customer agreements required dedicated time from our development team and such effort was recorded as cost of revenue during the period such services were delivered. In addition to the development team effort allocation, the Research and Development expense was impacted by an increase in employee stock based compensation as a result of the grant of stock options under the 2016 Equity Compensation plan.

General and Administrative expense increased by \$155,732 or 15% during the 2017 Period. This increase is attributable to an increase in employee stock based compensation.

Interest Expense decreased by \$474,141 or (13%). The cash part of interest expense increased by approximately \$290,000 due to the increase in the face value of our convertible debt. The cash interest portion was offset by a decrease of approximately \$760,000 in debt discount amortization as a result of the discount being amortized over additional two years attributable to the extension of the maturity date for our convertible debt, which was implemented in May 2016.



## Liquidity and Capital Resources

We have not yet achieved positive cash flows from operations, and our main source of funds for our operations continues to be the sale of our notes under the Convertible Note Facilities. We continue to rely on this source until we are able to generate sufficient cash from revenues to fund our operations or obtain alternate sources of financing. We believe that anticipated cash flows from operations, and additional issuances of notes, of which no assurance can be provided, together with cash on hand, will provide sufficient funds to finance our operations at least for the next 12 months from the date of this report on Form 10-Q. Changes in our operating plans, lower than anticipated sales, increased expenses, or other events may cause us to seek additional equity or debt financing in future periods. There can be no guarantee that financing will be available to us under the Convertible Note Facilities or otherwise on acceptable terms or at all. Additional equity and convertible debt financing could be dilutive to the holders of shares of our common stock, and additional debt financing, if available, could impose greater cash payment obligations and more covenants and operating restrictions.

Nonetheless, there are factors that can impact our ability to continue to fund our operating activities for the next twelve months. These include:

Our ability to expand revenue volume;

Our ability to maintain product pricing as expected, particularly in light of increased competition and its unknown effects on market dynamics;

Our continued need to reduce our cost structure while simultaneously expanding the breadth of our business, enhancing our technical capabilities, and pursuing new business opportunities.

In addition, we have an outstanding Loan and Security Agreement (the "LSA") with Comerica Bank in the amount of \$5 million, which matures in June of 2018 and is secured by an extended irrevocable letter of credit issued by UBS AG (Geneve, Switzerland) ("UBS AG") with a renewed term expiring on May 31, 2018, which term is renewable for one year periods, unless notice of non-renewal is given by UBS AG at least 45 days prior to the then current expiration date. If UBS were to elect to not renew the irrevocable letter of credit issued by it beyond May 31, 2018, the currently scheduled expiration date, then such non-renewal will result in an event of default under the LSA, at which time all amounts outstanding under the LSA of approximately \$5 million will become due and payable. Currently, the letter of credit is automatically extended for one year periods, unless notice of non-renewal is given by UBS AG at least 45 days prior to the then current expiration date. As of the date of this report on Form 10Q, no such notice has been provided to us nor have we been provided with any indication that we are to receive notice of non-renewal of the letter of credit.

Additionally, all notes issued under the 2007 and 2014 NPAs mature on November 14, 2018 and Comerica LSA matures on June 6, 2018.

In July of 2017 the Company consolidated multiple notes issued to the same noteholders under 2007 NPA or 2014 NPA into single note to each such shareholder so as to consolidate quarterly interest payments. All of the other terms and conditions, including the maturity date, remain in effect. The consolidated notes will continue to pay quarterly interest on a calendar quarter basis. Due to transition of quarterly payments to a calendar basis, the Company's interest payments on the consolidated notes is expected to decrease by approximately \$350,000 for the year ending December 31, 2017.

## Uses of Cash

During the nine months ended September 30, 2017, we used in operating activities approximately \$5.6 million, which was offset by \$2.8 million in cash collected from our customers, netting approximately \$2.8 million of net cash used in operating activities. Approximately \$2.3 million of this amount was used to pay interest payments on the convertible notes and bank debt; approximately \$2.5 million for payroll, benefits and related costs; approximately \$290,000 was used for non-payroll related sales and marketing efforts, such as tradeshow and marketing campaigns and approximately \$565,000 was used for other non-payroll development and general and administrative expenses, which included among other things: infrastructure costs, rent, insurance, legal, professional, compliance, and other expenditures.

During the nine months ended September 30, 2016, we used in operating activities approximately \$5.6 million, which was offset by \$1.7 million in cash collected from our customers, netting approximately \$3.9 million of net cash used in operating activities. Approximately \$2.4 million was used to pay interest payments on the convertible notes and bank debt; approximately \$2.4 million was used for payroll, benefits and related costs; approximately \$335,000 was used on non-payroll related sales and marketing efforts, such as tradeshow and marketing campaigns and approximately \$450,000 was used for other non-payroll development and general and administrative expenses, which included among other things: infrastructure costs, rent, insurance, legal, professional, compliance, and other expenditures.

## Capital Expenditures and Investing Activities

Our capital expenditures are limited to the purchase of new office equipment and new mobile devices that are used for testing. Cash used for investing activities was not significant and we do not plan any significant capital expenditures in the near future.

## Going Concern

Our independent registered public accounting firm has issued an emphasis of matter paragraph in their report included in the Annual Report on Form 10-K for the year ended December 31, 2016 in which they express substantial doubt as to our ability to continue as a going concern. The condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts or classification of liabilities that might be necessary should we be unable to continue as a going concern. Our continuation as a going concern depends on our ability to generate sufficient cash flows to meet our obligations on a timely basis, to obtain additional financing that is currently required, and ultimately to attain profitable operations and positive cash flows. There can be no assurance that our efforts to raise capital or increase revenue will be successful. If our efforts are unsuccessful, we may have to cease operations and liquidate our business.



### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

### ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures for the nine months ended September 30, 2017. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow for timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2017, our disclosure controls and procedures were effective at a reasonable assurance level.

#### Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2017, there were no changes made in our internal controls over financial reporting (as such term is defined in Rule 13a-15(f) of the Exchange Act) that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.





PART II – OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following paragraph sets forth certain information with respect to all securities sold by us during the three months ended September 30, 2017 without registration under the Securities Act:

Between July 1, 2017 and September 30, 2017, we issued to one accredited investor \$1,500,000 in principal amount of our convertible notes under the 2014 Note Purchase Agreement. The note is convertible into shares of our Common Stock at a per share conversion rate of \$1.43. All notes issued under this facility are scheduled to mature on November 14, 2018.

All of the securities issued in the transactions described above were issued without registration under the Securities Act in reliance upon the exemptions provided in Section 4(2) of the Securities Act. The recipient of securities in such transaction acquired the securities for investment only and not with a view to or for sale in connection with any distribution thereof. Appropriate legends were affixed to the share certificates issued in all of the above transactions. The recipient represented that it was an “accredited investor” within the meaning of Rule 501(a) of Regulation D under the Securities Act, or had such knowledge and experience in financial and business matters as to be able to evaluate the merits and risks of an investment in its common stock. The recipient had adequate access, through their relationships with the Company and its officers and directors, to information about the Company. None of the transactions described above involved general solicitation or advertising.

ITEM 6. EXHIBITS

Exhibit No.	Description
31.1	Certification of Principal Executive Officer Pursuant to Rule 13a-14(a) (Filed herewith)
31.2	Certification of Principal Financial and Accounting Officer Pursuant to Rule 13a-14(a) (Filed herewith)
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 (Furnished herewith)
32.2	Certification of Principal Financial and Accounting Officer Pursuant to 18 U.S.C. Section 1350 (Furnished herewith)
101.1	The following materials from the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows, (iv) the Condensed Consolidated Statement of Stockholders’ Deficit and (v) related notes to these condensed consolidated financial statements, tagged as blocks of text and in detail (Filed herewith).



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.

MOBILESMITH, INC.

November 13, 2017 By: /s/ Bob Dieterle  
Bob Dieterle  
Chief Executive Officer (Principal Executive Officer)

November 13, 2017 By: /s/ Gleb Mikhailov  
Gleb Mikhailov  
Chief Financial Officer (Principal Financial and Accounting Officer)





