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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 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 [X] Emerging growth company [ ]

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

The number of shares of Common Stock ($0.001 par value) outstanding as of August 6, 2018 was 5,883,109 shares.

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PART I

Item 1. Financial Statements

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Revenues	$4,192,331	$5,805,605	$8,173,386	$11,427,699
Cost of revenues	2,060,284	2,695,943	3,977,070	5,405,342
Gross profit	2,132,047	3,109,662	4,196,316	6,022,357
Operating expenses:				
Research and development	917,067	858,772	1,863,813	1,655,380
Sales and marketing	733,839	741,558	1,471,695	1,500,806
General and administrative	625,109	601,294	1,289,813	1,290,098
Total operating expenses	2,276,015	2,201,624	4,625,321	4,446,284
Operating income (loss)	(143,968)	908,038	(429,005)	1,576,073
Interest expense, net	(47,981)	(30,678)	(67,900)	(60,354)
Net income (loss) before income taxes	(191,949)	877,360	(496,905)	1,515,719
Income tax benefit (expense)	53,707	(387,437)	133,634	(639,988)
Net income (loss)	$(138,242)	$489,923	$(363,271)	$875,731
Net income (loss) per share:				
Basic	$(0.02)	$0.08	$(0.06)	$0.15
Diluted	$(0.02)	$0.07	$(0.06)	$0.12
Weighted average shares outstanding:				

Basic	5,880,296	5,965,479	6,309,816	5,939,304
Diluted	5,880,296	7,785,868	6,309,816	7,764,795

See accompanying notes to condensed financial statements.

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SOCKET MOBILE, INC.

CONDENSED BALANCE SHEETS

	June 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$1,296,314	$3,379,508
Accounts receivable, net	2,308,223	2,687,325
Inventories, net	2,212,940	2,198,266
Prepaid expenses and other current assets	297,653	385,508
Deferred cost on shipments to distributors	181,181	204,405
Total current assets	6,296,311	8,855,012
Property and equipment:		
Machinery and office equipment	2,180,742	2,052,091
Computer equipment	968,184	851,823
	3,148,926	2,903,914
Accumulated depreciation	(2,399,774)	(2,241,010)
Property and equipment, net	749,152	662,904
Goodwill	4,427,000	4,427,000
Other long-term assets	257,355	271,650
Deferred tax assets	5,771,114	5,637,480
Total assets	$17,500,932	$19,854,046
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$1,293,016	$1,112,234
Accrued payroll and related expenses	513,948	630,999
Deferred revenue on shipments to distributors	441,258	492,611
Current portion of deferred service revenue	31,477	31,536
Lines of credit	1,535,062	—
Term loan – current portion	547,222	—
Current portion of capital leases and deferred rent	58,270	55,382
Total current liabilities	4,420,253	2,322,762
Long term portion of deferred service revenue	28,567	29,447
Long term portion of capital leases and deferred rent	243,859	271,414
Term loan – long-term portion	452,778	—
Total liabilities	5,145,457	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 June 30, 2018 and 7,011,128 shares at December 31, 2017	5,883	7,011
Additional paid-in capital	60,267,071	64,777,620
Accumulated deficit	(47,917,479)	(47,554,208)
Total stockholders' equity	12,355,475	17,230,423
Total liabilities and stockholders' equity	$17,500,932	$19,854,046

See accompanying notes to condensed financial statements.

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

	Six Months Ended June 30,	
	2018	2017
Operating activities		
Net income (loss)	$(363,271)	$875,731
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Stock-based compensation	230,976	203,086
Depreciation and amortization	197,554	159,105
Changes in deferred taxes	(133,634)	613,989
Changes in operating assets and liabilities:		
Accounts receivable	379,102	(223,245)
Inventories	(14,674)	(696,709)
Prepaid expenses and other current assets	87,855	(247,529)
Other assets	435	11,640
Accounts payable and accrued expenses	180,782	(71)
Accrued payroll and related expenses	(117,051)	(26,979)
Net deferred income on shipments to distributors	(28,129)	35,921
Deferred service revenue	(939)	(420)
Change in deferred rent	(10,425)	(2,086)
Net cash provided by operating activities	408,581	702,433
Investing activities		
Purchases of equipment	(269,942)	(87,738)
Net cash used in investing activities	(269,942)	(87,738)
Financing activities		
Payments on capital leases	(14,242)	(12,961)
Proceeds from borrowings under bank line of credit agreement	5,716,353	—
Repayments of borrowings under bank line of credit agreement	(4,181,291)	—
Proceeds from bank term loan	4,000,000	—
Repayments of bank term loan	(3,000,000)	—
Common stock repurchases and related expenses	(5,021,830)	—
Stock options exercised	279,177	213,671
Net cash (used in) provided by financing activities	(2,221,833)	200,710
Net increase (decrease) in cash and cash equivalents	(2,083,194)	815,405

Cash and cash equivalents at beginning of period	3,379,508	1,319,006
Cash and cash equivalents at end of period	$1,296,314	$2,134,411
Supplemental disclosure of cash flow information		
Cash paid for interest	$56,749	$1,857

See accompanying notes to condensed financial statements.

SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

NOTE 1 — Basis of Presentation

The accompanying unaudited condensed 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 June 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

On January 1, 2017, the Company adopted ASU No. 2014-09 (now ASC 606 "Revenue from Contracts with Customers") and implemented a new revenue recognition policy. Instead of deferring 100% of revenue and cost of revenue until products are sold by distributors, under the new policy, we recognized 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 17% 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 June 30, 2018, the deferred revenue and deferred cost on shipments to distributors were approximately $441,000 and $181,000 respectively, compared to approximately $493,000 and $204,000, respectively, at December 31, 2017.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

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 June 30, 2018 and December 31, 2017 were as follows:

	June 30, 2018	December 31, 2017
Raw materials and sub-assemblies	$3,074,865	$3,016,327
Finished goods	9,670	67,120
Inventory reserves	(871,595	(885,181
Inventories, net	$2,212,940	$2,198,266

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. Accrued interest was $441,306 at June 30, 2017 and was included in Accounts Payable and Accrued Expenses. Interest expense on these convertible notes for the three and six months ended June 30, 2017 was $29,789 and $58,497, respectively.

NOTE 5 — Bank Financing Arrangements

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. 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.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

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 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.

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.

SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

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 pay down 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. The required Asset Coverage Ratio at June 30, 2018 was 1.0 to 1.0.

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 Asset Coverage Ratio increases to 1.2 to 1.0 on October 1, 2018 and to 1.25 to 1.0 on December 31, 2018.

As of June 30, 2018, the total amount borrowed under the domestic and international lines was $5.716 million and the total repayments was $4.181 million. No amounts were drawn during the six months ended June 30, 2017.

Interest expense on the term loan for three and six months ended June 30, 2018 was $34,924 and $56,730, respectively. Interest expense on the amounts drawn under the Company’s bank credit lines during the three and six months ended June 30, 2018 was $14,397. Accrued interest payable related to the amounts outstanding under the term loan and bank credit facilities at June 30, 2018 was $8,572.

NOTE 6 — Segment Information and Concentrations

Segment Information

The Company operates in the mobile barcode scanning and RFID/NFC data capture market. Mobile scanning typically consists of using mobile devices such as smartphones or tablets, with mobile scanning 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 by geographic area for three and six months ended June 30, 2018 and 2017 were as follows:

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Revenues:				
United States	$3,311,626	$4,666,816	$6,316,596	$9,008,465
Europe	639,640	831,526	1,283,389	1,931,208
Asia and rest of world	241,065	307,263	573,401	488,026
Total revenues	$4,192,331	$5,805,605	$8,173,386	$11,427,699

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 for the three and six-month periods ended June 30, 2018 and 2017 were:

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Ingram Micro Inc.	33%	33%	32%	39%
BlueStar, Inc.	22%	17%	22%	16%

ScanSource, Inc.	10%	26%	10%	20%

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 accounts receivable balances at June 30, 2018 and December 31, 2017 were as follows:

	June 30, 2018	December 31, 2017
Ingram Micro Inc.	38%	37 %
BlueStar, Inc.	32%	23 %
ScanSource, Inc.	*	10 %
Ingram Micro Pan Europe GmbH.	*	10 %

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

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

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 June 30, 2018, 27% of the Company’s accounts payable balances was concentrated in the top two suppliers. For the three months ended June 30, 2018, the top two suppliers accounted for 46% 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 six months ended June 30, 2018, was $118,843 and $230,976, respectively. Total stock-based compensation expense for the three and six months ended June 30, 2017, was $107,389 and $203,086, respectively. In the three and six months ended June 30, 2018, 259,700 stock options were granted at a weighted average per share fair value estimated at $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 June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Numerator:				
Net income (loss)	$(138,242)	$489,923	$(363,271)	$875,731
Convertible note interest	—	$29,789	—	$58,497
Adjusted diluted net income (loss)	$(138,242)	$519,712	$(363,271)	$934,228
Denominator:				
Basic	5,880,296	5,965,479	6,309,816	5,939,304
Effect of dilutive stock options and convertible notes payable	—	1,820,389	—	1,825,491
Diluted	5,880,296	7,785,868	6,309,816	7,764,795
Net income (loss) per share applicable to common stockholders:				
Basic	$(0.02)	$0.08	$(0.06)	$0.15
Diluted	$(0.02)	$0.07	$(0.06)	$0.12

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

In the three and six months ended June 30, 2018, 2,359,034 stock options were excluded in the calculation of diluted net loss per share because their effect would be anti-dilutive.

NOTE 9 — 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%. In the three and six months ended June 30, 2018, the Company recorded deferred tax benefits of $53,707 and $133,634, respectively, based on an expectation of at least a breakeven in its full year's results. In the same periods one year ago, the Company recorded income tax expenses of $387,437 and $639,988, respectively. Income tax expense is offset for income tax purposes by Federal and State net operating loss carryovers.

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 per year annually on July 1st of each year. Rental expense was $109,851 and $219,918 for the three and six-month periods ended June 30, 2018, respectively. Rental expense was $109,237 and $218,036 for the three and six-month periods ended June 30, 2017, respectively. The Company recorded a deferred rent obligation in accrued liabilities in the amount of $263,962 and $274,388 at June 30, 2018 and December 31, 2017, respectively.

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

Annual minimum payments:	Amount
2018 (July 1, 2018 to December 31, 2018)	$225,516
2019	460,053
2020	478,455
2021	497,594
2022 (through June 30, 2022)	253,675
Total minimum payments	$1,915,293

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

Capital Lease Obligations

The Company leases certain of its equipment under capital leases. These leases are collateralized by their underlying assets. At June 30, 2018 and December 31, 2017, 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 June 30, 2018 and December 31, 2017, amounted to $65,493 and $51,400 respectively.

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

Annual minimum payments:	Amount
2018 (July 1, 2018 to December 31, 2018)	$12,015
2019	17,892
2020	9,164
Total minimum payments	39,071
Less amount representing interest	(904)
Present value of net minimum payments	38,167
Short term portion of capital leases	(20,071)
Long term portion of capital leases	$18,096

Purchase Commitments

As of June 30, 2018, the Company has non-cancelable purchase commitments for inventory to be used in the ordinary course of business of approximately $3,215,000.

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.

Recently Issued Financial Accounting Standards

In June 2018, the FASB issued ASU 2018-07 Compensation – Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting. This ASU is intended to simplify aspects of share-based compensation issued to non-employees by making the guidance consistent with the accounting for employee share-based compensation. It is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2018 and is not expected to have a significant impact on the Company's financial statements.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (Unaudited)

June 30, 2018

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 upon adoption.

NOTE 11 — Subsequent Events

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 Asset Coverage Ratio increases to 1.2 to 1.0 on October 1, 2018 and to 1.25 to 1.0 on December 31, 2018.

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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.

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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 NFC/RFID enabled mobile applications.

We design our own products and subcontract the manufacturing of product components to independent third-party contract manufacturers who are located in the U.S., Mexico, Singapore, Malaysia, Indonesia 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 that we serve 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 barcode scanners

We offer a full range of handheld cordless barcode scanners connecting to smartphones, tablets and other computing devices over Bluetooth. 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 that will eventually replace the 7 Series. The SocketScan 700 Series come in three modules: 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.

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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 was successfully completed. The Capture SDK 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 has been restructured to better support our existing iOS and Android developers by enabling them to develop in their preferred development environments and make it easier and quicker to integrate scanner support. The Capture SDK enables us to support many development environments that corporate developers prefer.

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.

Revenues

Total revenues for the three and six months ended June 30, 2018 were $4.2 million and $8.2 million, respectively, a decrease of 28% from revenues of $5.8 million and $11.4 million, respectively, in the comparable periods one year ago. Our product revenues and the corresponding decrease and increase in revenues for the comparable periods are shown in the following table:

(revenues in thousands)	Three Months Ended June 30,			Six Months Ended June 30,		
Product family:	2018	2017	Increase (Decrease)	2018	2017	Increase (Decrease)
Cordless scanners and accessories	$4,135	$5,687	(27 %)	$8,022	$11,236	(29 %)
OEM/Legacy products	5	68	(93 %)	52	82	(37 %)
Services	52	51	2 %	99	110	(10 %)
Total	$4,192	$5,806	(28 %)	$8,173	$11,428	(28 %)

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Revenue of our *cordless barcode scanners and accessories* was $4.14 million or 99% of our overall revenues for the second quarter of 2018, a decrease of 27% or $1.55 million compared to the revenue of $5.69 million for the second quarter of 2017. Revenue for the six months ended June 30, 2018 was $8.0 million, a decrease of 29% or $3.2 million compared to the revenue of $11.2 million in the same period a year ago. Lower revenue for the three and six-month periods ended June 30, 2018 is primarily due to a lack of enterprise deployments during 2018. Revenue in 2017 included large shipments of cordless barcode scanner orders to two customers of $0.7 million and $1.9 million for the three and six-month periods ended June 30, 2017, respectively, whereas shipments in the first half of 2018 were primarily fulfilling smaller unit orders. Lower revenue in 2018 is also due to delays in shipping of our new SocketScan products. 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. With the delivery of our new products, our developers have started their qualification of the new products, which may take several months to evaluate and recommend our new products.

Service comprised 1% of revenue for the three and six-month periods ended June 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 six-month periods ended June 30, 2018 were 50.9% and 51.3%, respectively, compared to 53.6% and 52.7%, 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. Q2 2018 gross margins were also impacted by the higher costs associated with expedited production of the first 1,200 units of the new SocketScan products shipped in April and May.

Research and Development Expense

Research and development expense in the three and six months ended June 30, 2017 were $917,000 and $1,864,000, an increase of 7% and 13% compared to expenses of $859,000 and $1,656,000 in the corresponding periods a 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. We expect research and development expense to remain flat for the remainder of the year.

Sales and Marketing Expense

Sales and marketing expense in the three and six months ended June 30, 2018 were $734,000 and $1,472,000, a decrease of 1% and 2% compared to the expense of $742,000 and $1,501,000 in the corresponding periods a year ago. Sales and marketing expense for the second half of 2018 is expected to remain flat.

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General and Administrative Expense

General and administrative expense in the second quarter of 2018 was $625,000, an increase of 4% compared to expense of $601,000 in Q2 2017. Expense in the six-month period of both 2018 and 2017 was at the same level, $1.29 million. General and administrative expense is expected to decline slightly for the balance of 2018.

Interest Expense, Net of Interest Income

Interest expense, net of interest income, in the three and six months ended June 30, 2018 was $47,981 and $67,900, respectively, compared to $30,678 and $60,354, 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 six months of 2018 was $2.75 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 first quarters includes interest on equipment lease financing obligations.

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

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%. 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.

In the three and six months ended June 30, 2018, we recorded deferred tax benefits of $53,707 and $133,634, respectively, based on an expectation of at least a breakeven in our full year's results. In the same period one year ago, we recorded income tax expenses of $387,437 and $639,988, respectively. Our deferred tax asset, primarily representing future income tax savings from the application of net operating loss carry forwards, was valued at

$5,771,000 at June 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.

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Cash Flows and Contractual Obligations

As reflected in our Statements of Cash Flows, net cash provided by operating activities was $409,000 in the first half of 2018, compared to net cash provided by operating activities of $702,000 in the comparable period a year ago. We calculate net cash provided by operating activities by decreasing our net loss ($363,000 in the first half of 2018) or increasing our net income ($876,000 in the first half of 2017) by the expenses, such as stock based compensation expense, depreciation, and deferred tax expense, that did not require the use of cash. These amounts totaled $295,000 and $976,000 in the first half 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 half of 2018, changes in operating assets and liabilities resulted in a net source of cash of $477,000 and were primarily from reductions in accounts receivables due to lower overall shipments to our distributors in the first half of 2018, increases in accounts payables due to the timing of vendor payments, and partially offset by the decreases of accrued liabilities. In the first six months of 2017, changes in operating assets and liabilities resulted in a net use of cash of $1,149,000 which was primarily due to the buildup of inventories to accommodate rising sales, increases in accounts receivable driven by the higher shipments in the second half of Q2 2017, prepayments for insurance policies and operating leases, and increases in capitalized software development costs for our new product D600.

In the first half of 2018 and 2017, we invested $270,000 and $88,000, respectively, in manufacturing tooling costs and computer software development costs.

Net cash used in financing activities was $2.2 million in the first half of 2018, compared to net cash provided of $201,000 in the comparable period a year ago. Financing activities in the first half of 2018 consisted primarily of the $5.0 million use of cash related to repurchase of company stock, partially offset by net $1.0 million borrowed on our term loan, net $1.5 million borrowed on our bank lines of credit, and $279,000 proceeds from the exercise of stock options. Financing activities in the first quarter of 2017 consisted primarily of the proceeds from the exercise of stock options.

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

		Payments Due by Period			
Contractual Obligations	Total	Less than 1 year	1 to 3 years	4 to 5 years	More than 5 years

Unconditional purchase obligations with contract manufacturers	$3,215,000	$3,215,000	$—	$—	$ —
Operating lease	1,915,000	451,000	957,000	507,000	—
Capital leases	39,000	21,000	18,000	—	—
Total contractual obligations	$5,169,000	$3,687,000	$975,000	$507,000	$ —

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Off-Balance Sheet Arrangements

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

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 June 30, 2018, an increase of 1% in the interest rate would have increased our second quarter borrowing costs by approximately $7,000.

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 June 30, 2018, an adverse change of 10% in exchange rates would have resulted in an decrease in our net income for the second quarter of 2018 of approximately $42,600 if left unprotected. For the second 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 $12,700. We will continue to monitor, assess, and mitigate through hedging activities, our risks related to foreign currency fluctuations.

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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 June 30, 2017 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.

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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 two 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.

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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 in order 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 systems 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 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, should 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.

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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.

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.

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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.

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.

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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 half year of 2018 and 2017, Ingram Micro Inc., ScanSource, Inc., and BlueStar, Inc. together represented approximately 64% and 75%, 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.

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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.

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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 into 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 into 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/Windows Mobile). 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.

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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.

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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.

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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.

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.

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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 in order 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 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.

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 August 6, 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 August 6, 2018, we had 2,358,134 shares of common stock subject to outstanding options under our stock option plans, and 132,693 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.

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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 August 6, 2018, our common stock price fluctuated between a high of $4.90 and a low of $1.86. 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.

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Item 6. 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.

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

Date: August 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)

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Index to Exhibits

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