MobileSmith, Inc.
Form 10-Q
May 06, 2016

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 March 31, 2016

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<br>Raleigh, North Carolina | 27607 |
|---|---|
| (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). Yes 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. (Check one):

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

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

As of May 5, 2016, there were 19,827,542 shares of the registrant’s common stock, par value $0.001 per share, outstanding.

MOBILESMITH, INC.

FORM 10-Q
For the Quarterly Period Ended March 31, 2016

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PART I – FINANCIAL INFORMATION

MOBILESMITH, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

| | March 31, 2016 (unaudited) | December 31, 2015 |
|---|---|---|
| Current Assets | | |
| Cash and Cash Equivalents | $366,258 | $580,220 |
| Restricted Cash | 73,527 | 124,988 |
| Trade Accounts Receivable, Net of Allowance for Doubtful Accounts of $16,050 | 396,163 | 183,350 |
| Prepaid Expenses and Other Current Assets | 71,382 | 69,552 |
| Total Current Assets | 907,330 | 958,110 |
| Property & Equipment, Net | 94,912 | 98,963 |
| Capitalized Software, Net | 363,512 | 390,518 |
| Intangible Assets, Net | 50,725 | 55,099 |
| Other Assets | 2,502 | 6,264 |
| Total Other Assets | 511,651 | 550,844 |
| Total Assets | $1,418,981 | $1,508,954 |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| Current Liabilities | | |
| Trade Accounts Payable | $101,048 | $45,717 |
| Accrued Expenses | 200,628 | 247,858 |
| Accrued Interest | 355,395 | 350,613 |
| Capital Lease Obligations | 31,535 | 30,877 |
| Deferred Revenue | 1,315,122 | 1,007,970 |
| Bank Loan | 5,000,000 | 5,000,000 |
| Convertible Notes Payable, Related Parties, Net of Discount | 34,662,120 | 33,363,488 |
| Convertible Notes Payable, Net of Discount | 680,640 | 680,640 |
| Total Current Liabilities | 42,346,488 | 40,727,163 |
| Long-Term Liabilities | | |
| Capital Lease Obligations | 75,626 | 83,761 |
| Deferred Rent | 50,928 | 53,592 |

| | | |
|---|---|---|
| Total Long-Term Liabilities | 126,554 | 137,353 |
| Total Liabilities | 42,473,042 | 40,864,516 |
| | | |
| Commitments and Contingencies (Note 3) | | |
| Stockholders' Deficit | | |
| Preferred Stock, $0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding at March 31, 2016 and December 31, 2015 | - | - |
| Common Stock, $0.001 par value, 45,000,000 shares authorized, 19,827,542 shares issued and outstanding at March 31, 2016 and December 31, 2015 | 19,828 | 19,828 |
| Additional Paid-in Capital | 97,965,453 | 97,545,601 |
| Accumulated Deficit | (139,039,342) | (136,920,991) |
| Total Stockholders' Deficit | (41,054,061) | (39,355,562) |
| Total Liabilities and Stockholders' Deficit | $1,418,981 | $1,508,954 |

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

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

| | Three Months Ended | |
|---|---|---|
| | March 31, 2016 | March 31, 2015 |
| REVENUES: | | |
| Subscription and Support | $471,130 | $396,188 |
| Professional Services and Other | - | 30,000 |
| Total Revenue | 471,130 | 426,188 |
| COST OF REVENUES: | | |
| Subscription and Support | 115,321 | 59,469 |
| Professional Services and Other | 5,063 | 9,273 |
| Total Cost of Revenue | 120,384 | 68,742 |
| GROSS PROFIT | 350,746 | 357,446 |
| OPERATING EXPENSES: | | |
| Sales and Marketing | 235,724 | 292,199 |
| Research and Development | 406,543 | 340,140 |
| General and Administrative | 352,973 | 314,566 |
| Total Operating Expenses | 995,240 | 946,905 |
| LOSS FROM OPERATIONS | (644,494) | (589,459) |
| OTHER INCOME (EXPENSE): | | |
| Other Income | 8,039 | 379 |
| Interest Expense, Net | (1,481,896) | (1,267,136) |
| Total Other Expense | (1,473,857) | (1,266,757) |
| NET LOSS | $(2,118,351) | $(1,856,216) |
| NET LOSS PER COMMON SHARE: | | |
| Basic and Fully Diluted | $(0.11) | $(0.09) |
| WEIGHTED-AVERAGE NUMBER OF SHARES USED IN COMPUTING NET LOSS PER COMMON SHARE: | | |
| Basic And Fully Diluted | 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)

| | Three Months Ended | |
|---|---|---|
| | March 31, 2016 | March 31, 2015 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Loss | $(2,118,351) | $(1,856,216) |
| Adjustments to Reconcile Net Loss to Net Cash Used in Operating Activities: | | |
| Depreciation and Amortization | 40,630 | 40,567 |
| Bad Debt Expense (Gain on Reversal of Bad Debt) | - | (6,000) |
| Amortization of Debt Discount | 697,233 | 583,432 |
| Share Based Compensation | 21,251 | 21,308 |
| Changes in Assets and Liabilities: | | |
| Accounts Receivable | (212,813) | 75,871 |
| Prepaid Expenses and Other Assets | 1,932 | (18,138) |
| Accounts Payable | 55,331 | 11,292 |
| Deferred Revenue | 307,152 | (101,110) |
| Accrued and Other Expenses | (45,112) | (177,651) |
| Net Cash Used in Operating Activities | (1,252,747) | (1,426,645) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Payments to Acquire Property, Plant and Equipment | (5,199) | (4,916) |
| Net Cash Used in Investing Activities | (5,199) | (4,916) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Restricted Cash Used to Pay Interest Expense | 51,461 | 49,752 |
| Proceeds from Issuance of Long Term Debt | 1,000,000 | 1,700,000 |
| Repayments of Debt Borrowings | (7,477) | (6,871) |
| Net Cash Provided by Financing Activities | 1,043,984 | 1,742,881 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (213,962) | 311,320 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 580,220 | 320,286 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $366,258 | $631,606 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash Paid During the Period for Interest | $775,723 | $804,328 |
| Non-Cash Investing and Financing Activities | | |
| The Company Recorded Debt Discount Associated with Beneficial Conversion Feature | $398,601 | $- |

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 MARCH 31, 2016
(unaudited)

| | Common Stock | | Additional | | |
|---|---|---|---|---|---|
| | | $0.001 | Paid-In | Accumulated | |
| | Shares | Par Value | Capital | Deficit | Totals |
| BALANCES, DECEMBER 31, 2015 | 19,827,542 | $19,828 | $97,545,601 | $(136,920,991) | $(39,355,562) |
| Equity-Based Compensation | | - | 21,251 | - | 21,251 |
| Beneficial Conversion Feature Recorded as a Result of Issuance of Convertible Debt | | - | 398,601 | - | 398,601 |
| Net Loss | | - | | (2,118,351) | (2,118,351) |
| BALANCES, MARCH 31, 2016 | 19,827,542 | $19,828 | $97,965,453 | $(139,039,342) | $(41,054,061) |

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 March 31, 2016
(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 software products and services and targets businesses whose need is to connect with their stakeholders (customers, employees, broader public) through a variety of mobile devices and do so with the fastest time to market possible, while by-passing the need to write a single line of code. The Company's flagship product is the MobileSmith® Platform (the "Platform"). The Platform is an innovative app development platform that enables organizations to rapidly create, deploy, and manage custom, native smartphone and tablet apps deliverable across iOS and Android mobile platforms without writing a single line of code.

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 2016.

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;

dedicated internal and secure mobile development platform for the U.S. Department of Defense and related contractors;

custom mobile application design and development services;

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 March 31, 2016. 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, 2015 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 three months ended March 31, 2016 and 2015, 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 March 31, 2016, 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. All pronouncements that are expected to affect future year financial statements are disclosed in the Annual Report on Form 10-K for the year ended December 31, 2015.

2. DEBT

The table below summarizes the Company's debt at March 31, 2016 and December 31, 2015:

| Debt Description | March31, 2016 | December31, 2015 | Maturity | Rate |
|---|---|---|---|---|
| Comerica Bank LSA | $5,000,000 | $5,000,000 | June 2016 | 3.85% |
| Capital lease obligations - Noteholder lease | 86,800 | 92,270 | August 2019 | 8.00% |
| Capital lease obligations - office furniture | 20,361 | 22,368 | September 2016 | 9.80% |
| Convertible notes - related parties, net of discount of $1,712,111 and $2,010,743, respectively | 34,662,120 | 33,363,488 | November 2016 | 8.00% |
| Convertible notes, net of discount of $50,129 | 680,640 | 680,640 | November 2016 | 8.00% |
| Total debt | 40,449,921 | 39,158,766 | | |
| Less: current portion of long term debt | | | | |
| Capital lease obligations | 31,535 | 30,877 | | |
| Comerica Bank LSA | 5,000,000 | 5000000 | | |
| Convertible notes - related parties, net of discount of $1,712,111 and $2,010,743, respectively | 34,662,120 | 33,363,488 | | |
| Convertible notes, net of discount of $50,129 | 680,640 | 680,640 | | |
| Total current portion of long term debt | 40,374,295 | 39,075,005 | | |
| Debt - long term | $75,626 | $83,761 | | |

Convertible Notes

During the three months ended March 31, 2016, the Company privately placed $1,000,000 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 market value of the Company's common stock on the date of issuance of the $1,000,000 2014 NPA Note to UBP was higher than the conversion price, which

resulted in a beneficial conversion feature of $398,601 and corresponding debt discount, which is being amortized into interest expense through the maturity of the Note.

The table below summarizes convertible notes issued as of March 31, 2016 by type:

| Convertible Notes Type: | Balance |
|---|---|
| 2007 NPA notes, net of discount | $29,082,353 |
| 2014 NPA notes, net of discount | 6,260,407 |
| Total convertible notes, net of discount | $35,342,760 |

3. COMMITMENTS AND CONTINGENCIES

Aggregate future lease commitments

The Company leases computers, office equipment and office furniture under capital lease agreements that expire through August 2019. Total amount financed under these capital leases at March 31, 2016 was $107,161. This obligation is included within the Company's total debt.

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

| Year: | |
|---|---|
| 2016 | $29,444 |
| 2017 | 39,259 |
| 2018 | 34,189 |
| 2019 | 19,412 |
| | 122,304 |
| Less amount representing interest | (15,143) |
| Capital lease obligations | $107,161 |

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 three-year terms. In addition, the Company leases a vehicle pursuant to a lease that expires in July 2016.

The table below summarizes the Company's future obligations under its office and vehicle operating leases:

| Year: | |
|---|---|
| 2016 | $124,146 |
| 2017 | 167,786 |
| 2018 | 172,418 |
| 2019 | 44,082 |
| Total | $508,432 |

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 COMPENSATION

The following is a summary of the stock option activity for the three months ended March 31, 2016:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding, December 31, 2015 | 361,349 | $1.44 | | |
| Cancelled | (75,000) | 1.50 | | |
| Issued | - | - | | |
| Outstanding, March 31, 2016 | 286,349 | $1.42 | 2.62 | $166,338 |
| Vested and exercisable, March 31, 2016 | 223,285 | $1.36 | 2.93 | $142,084 |

Aggregate intrinsic value represents the difference between the closing price of the Company's common stock at March 31, 2016 and the exercise price of outstanding, in-the-money stock options. The closing price of the common stock at March 31, 2016, as reported on the Over-the-Counter Bulletin Board, was $2.00 per share.

At March 31, 2016, $39,690 unvested expense has yet to be recorded related to outstanding stock options.

5. MAJOR CUSTOMERS AND CONCENTRATION

For the three months ended March 31, 2016, one major customer accounted for 15% of total revenues and one customer accounted for 62% of the accounts receivable balance. For the three months ended March 31, 2015, three major customers accounted for 44% of total revenues and three customers accounted for 66% of the accounts receivable balance.

6. SUBSEQUENT EVENTS

On April 14, 2016, the Company issued one 2014 NPA Note to UBP in the principal amount of $700,000 on the same terms as the currently outstanding 2014 NPA Notes. The note matures on November 14, 2016.

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, 2015 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 a software-as-a-service ("SaaS") platform that allows non-programmers to design and build native mobile applications for smartphones and tablets. Our flagship product is the MobileSmith® Platform (the "Platform"). Platform related services often include data integration and training. 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. Out 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 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.

Our market penetration strategy focuses on three distinct sectors:

Healthcare clients:

Healthcare organizations, such as hospitals and healthcare networks, follow departmental segmentation and focus on a specific territorial reach. Additionally, healthcare organizations are subject to increased regulation as a result of the Affordable Care Act and may be subject to penalties for delivering inefficient care under new Medicare regulations. Hospitals increasingly turn to portfolios of apps to increase efficiency and remain competitive. Outpatient care apps, wellness apps, physician referral apps, appointment apps, discharge apps, facility way-finding apps are just a few example areas where healthcare organizations are increasingly using app portfolios. We believe that the Platform has a significant competitive advantage in the healthcare space due to its ability to deliver a variety of targeted mobile solutions cost effectively.

Enterprise clients:

The second sector combines all other large and multi-national enterprise clients, where large-scale customization based on functionality or territory is of the highest value, and other contributors such as time to market, technology reach, and ease of use play important roles. These target clients may include large food chains, media and PR companies, software solutions providers, hardware manufacturers, mortgage brokers and real estate franchises.

Government:

We believe that the Platform has a unique capability to service various structures within federal, state and local governments, as government structure is highly segmented by function and territory. In addition, the Platform can be safely placed behind the firewalls of individual departments, where data security is a primary concern. Replicating the Platform and placing it behind a secure firewall would allow an organization to create and manage multiple mobile apps with targeted functionality for targeted audiences without going outside of the secure firewall.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended March 31, 2016 (the "2016 Period") to the Three Months Ended March 31, 2015 (the "2015 Period").

| | Three months ended March 31 | | Increase (Decrease) | |
|---|---|---|---|---|
| | 2016 | 2015 | $ | % |
| Revenue | 471,130 | 426,188 | 44,942 | 11% |
| Cost of Revenue | 120,384 | 68,742 | 51,642 | 75% |
| Gross Profit | 350,746 | 357,446 | (6,700) | (2%) |
| Sales and Marketing | 235,724 | 292,199 | (56,475) | (19%) |
| Research and Development | 406,543 | 340,140 | 66,403 | 20% |
| General and Administrative | 352,973 | 314,566 | 38,407 | 12% |
| Interest Expense | 1,481,896 | 1,267,136 | 214,760 | 17% |

Revenue increased by $44,942, or 11%. As the Platform evolves, we continue to add new features and extend our market penetration, expand our customer base and retain larger customers with broader ranges of needs in the mobile space who enter into more significant contracts for subscription revenue. Included in the total revenue in the 2015 Period was $30,000 of professional services revenue generated from one of our subscription clients. The professional services consisted of implementation of advanced Platform features, advanced data integration and mobile consulting. No such services were provided during 2016 period. We don't expect professional services revenue to be a significant share of our total revenue in the future. Our revenues were impacted by one major contract for which revenue recognition has been deferred and has not yet started as of March 31, 2016 due to specifics of US GAAP ("United States Generally Accepted Accounting Principles") revenue recognition requirements for sale of software products and services. Such deferred revenue was approximately $600,000, which comprised approximately 44% of the total deferred revenue balance. Once all revenue recognition criteria are met, the revenue will be recognized in accordance with our revenue recognition policy.

Cost of Revenue increased by $51,642 or 75%. General increase in cost of revenue is attributable to the reorganization and growth of our Customer Success team, which resulted in growth in payroll and benefits cost of approximately $35,000. Our Customer Success team expanded during the 2015 period as our revenue continues to increase. In addition, the cost of revenue included $11,500 of outsourced custom development work, compared to zero during the same period of last year.

Gross Profit decreased by $6,700 or 2%. Such decrease is attributable to that fact that the Company continued investment into Customer Success team to support the growth in revenue. Due to specifics of US GAAP software revenue recognition rules there are, and may occur in the future, situations where the recognition of revenue is deferred, but the costs to deliver such revenue are recognized when incurred, resulting in gross profit growth lagging the growth in revenues.

Sales and Marketing expense decreased by $56,475, or 19%. A decrease of approximately $18,000 is attributable to turnover in our sales and marketing team. Additionally, a decrease of approximately $27,000 is attributable to a decrease in volume of marketing campaigns and tradeshows as we re-evaluated our key marketing activities with a goal of accelerating the spending in the following quarter.

Research and Development expense increased by $66,403 or 20%. This increase is mostly attributable to an increase in payroll and related costs as a result of expanding our developer team, as well as increase in team's general compensation levels as we continue to compete for top talent in a highly competitive labor market for software engineers and developers.

General and Administrative expense increased by $38,407 or 12% during the 2016 period. There was not a single significant source for such an increase, but rather a combination of small increases, which included increase in payroll expense, general legal and compliance costs, modest investments in hardware and software tools, change in bad debt expense and other expenses.

Interest Expense increased by $214,760 or 17%. Approximately $102,000 of the increase was attributable to the increase in the face value of our debt and the remaining $113,000 of the increase was mainly due to the increase in non-cash debt discount amortization.

Liquidity and Capital Resources

We have not yet achieved positive cash flows from operations, and our main source of funds for our operations is the sale of our notes under our two convertible note facilities, both of which expire in November 2016. We need to 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. 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. The convertible note facilities are scheduled to expire on November 14, 2016 and all outstanding notes thereunder, which stood at $37,805,000 as of the date of this report, are to come due and payable. 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 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 pursing new business opportunities.

the refusal of the lenders under the convertible note facilities to extend the facility or the due date of the outstanding notes thereunder beyond November 14, 2016.

In addition, if UBS were to elect to not renew the irrevocable letter of credit issued by it beyond May 31, 2016, the currently scheduled expiration date, then such non-renewal will result in an event of default under our Loan and Security Agreement (the “LSA”) with Comerica Bank, at which time all amounts outstanding thereunder, which are approximately $5,000,000 as of the date of this report, 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.

All notes issued under the 2007 and 2014 NPAs mature on November 14, 2016. In an initial discussion that took place in January of 2016 and subsequent discussion, the Bondholders’ representative and some of the Bondholders indicated

their willingness and ability to extend the maturity of the 2007 and 2014 NPAs by two years. However, no assurance can be provided that we will be successful in obtaining any such extension on terms commercially acceptable to us or at all.

The LSA is scheduled to mature on June 9, 2016 and the Company is currently in discussions with Comerica Bank to extend the maturity of LSA by similar terms for two additional years. The management of the company believes that it will be able to extend maturity dates or refinance all of its debt maturing in 2016 on similar terms. No assurance can be provided that we will be successful in obtaining an extension on commercially reasonable terms or at all.

Uses of Cash

During the three months ended March 31, 2016, we used in operating activities approximately $1.8 million, which was offset by $600,000 in cash collected from our customers; of which approximately $775,000 was used to pay interest payments on the Notes and bank debt; approximately $740,000 was used for payroll, benefits and related costs; approximately $95,000 was used on non-payroll related sales and marketing efforts, such as tradeshows and marketing campaigns and approximately $230,000 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 three months ended March 31, 2015, we used in operating activities approximately $1.8 million, which was offset by $400,000 in cash collected from our customers; of which approximately $804,000 was used to pay interest payments on the Notes and bank debt; approximately $646,000 was used for payroll, benefits and related costs; approximately $137,000 was used on non-payroll related sales and marketing efforts, such as tradeshows and marketing campaigns and approximately $219,000 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, 2015 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 three months ended March 31, 2016. 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 March 31, 2016, our disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control over Financial Reporting

During the three months ended March 31, 2016, there were no changes made in our internal control 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 control 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 March 31, 2016 without registration under the Securities Act:

Between January 1, 2016 and March 31, 2016, we issued to one accredited investor $1,000,000 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, 2016.

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 March 31, 2016, 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.

May 6, 2016 By: /s/ Amir Elbaz
Amir Elbaz
Chief Executive Officer

May 6, 2016 By: /s/Gleb Mikhailov
Gleb Mikhailov
Chief Financial Officer

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