



**(510) 933-3000**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, \$0.001 Par Value per Share	OTCQB

Securities registered pursuant to Section 12(g) of the Exchange Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES  NO

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

Indicate by check mark 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  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.  
[X]

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]

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

As of June 30, 2013, the aggregate market value of the registrant's Common Stock (\$0.001 par value) held by non-affiliates of the registrant was \$7,607,943 based on the closing sale price as reported on the Over the Counter Marketplace system.

Number of shares of Common Stock (\$0.001 par value) outstanding as of March 21, 2014: 4,904,563 shares

#### DOCUMENTS INCORPORATED BY REFERENCE

Items 10, 11, 12, 13, and 14 of Part III are incorporated by reference from the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 15, 2014. Such Proxy Statement will be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.



**TABLE OF CONTENTS**

**PART I**

<u>Item 1. Business</u>	<u>1</u>
<u>Item 1A. Risk Factors</u>	<u>8</u>
<u>Item 1B. Unresolved Staff Comments</u>	<u>19</u>
<u>Item 2. Properties</u>	<u>19</u>
<u>Item 3. Legal Proceedings</u>	<u>20</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>20</u>

**PART II**

<u>Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>20</u>
<u>Item 6. Selected Financial Data</u>	<u>22</u>
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>23</u>
<u>Item 7A. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>32</u>
<u>Item 8. Financial Statements and Supplementary Data</u>	<u>32</u>
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>58</u>
<u>Item 9A. Controls and Procedures</u>	<u>58</u>
<u>Item 9B. Other Information</u>	<u>59</u>

**PART III**

<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	<u>60</u>
<u>Item 11. Executive Compensation</u>	<u>60</u>
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>60</u>
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	<u>60</u>
<u>Item 14. Principal Accounting Fees and Services</u>	<u>61</u>

**PART IV**

<u>Item 15. Exhibits, Financial Statement Schedules</u>	<u>61</u>
---	-----------

**SIGNATURES**

62

**Index to Exhibits**

63



## **PART I**

*This Annual 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 handheld computers and other mobile computing devices, growth in demand for our products, expansion of the markets that we serve, expansion of the distribution channels for our products, adoption of our embedded products by third-party manufacturers of electronic devices, 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: continued weakness in the U.S. and 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 announced third-party handheld computer 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 handheld computers and barcode scanners; market acceptance of emerging standards such as Bluetooth® and wireless LAN and of our related connection, data collection and mobile handheld computer 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-K including “Item 1A. Risk Factors” and recent Form 8-K and Form 10-Q 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 financial statements and notes included elsewhere in this report, and other information contained in other reports and documents filed from time to time with the Securities and Exchange Commission.*

### **Item 1. Business**

#### **The Company**

We are a producer of mobile cordless barcode scanners and handheld computers for the business mobility markets, generating 62 percent and 34 percent respectively of our 2013 revenue, compared to 44 percent and 53 percent respectively of our 2012 revenue. Our markets for our barcode scanning products as defined by Venture Development Corporation (a leading technology market research firm) include retail, commercial services and healthcare.

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1



## Table of Contents

Our products are designed for a mobile worker using applications running on mobile devices while walking or standing. We offer easy-to-use software developer kits to application developers that enable the integration of our barcode scanning software into mobile applications running on Smartphones, tablets and mobile computers. These devices use operating systems from Apple® (iOS), Google™ (Android™) and Microsoft® (Windows®/Windows Mobile™). We focus on serving the needs of application developers as our barcode scanner sales are application driven. Once we are built into an application, our products become an ingredient of their solutions and marketing programs. Our registered developer program for barcode scanning has grown to over 700 developers which include developers of third party applications such as retail point of sale software licensed to customers and developers building in-house commercial services programs for business entities. We offer barcode scanning models for both 1D and 2D barcode scanning, and all connect cordlessly with a Smartphone, tablet or mobile computer over Bluetooth. We design our own products and test and assemble product components obtained from third party contract manufacturers. We perform final product assembly and testing and package and distribute our products at and from our Newark, California facility. We offer our products worldwide through two tier distribution enabling customers to purchase from a large number of resellers of electronic products around the world. 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, building a growing demand for our products. Our barcode scanning products address the growing need for speed and accuracy by today's mobile workers, thereby enhancing their productivity and allowing them to exploit time sensitive opportunities and improve customer satisfaction.

## **Products**

### *Cordless barcode scanners*

We offer a family of cordless barcode scanning products that connect over Bluetooth with smartphones, tablets and mobile computers running operating systems from Apple (iOS), Google (Android), and Microsoft (Windows/Windows Mobile). Our cordless barcode scanners include two dimensional (2D) and linear (1D) barcode scanners in both durable and colorful cases. Our series 7 models are lightweight and ergonomically designed as a standalone handheld barcode scanner and are widely used with tablet computers. Our series 8 models can be used stand-alone or attach to a Smartphone to enable one-handed barcode scanning. We also offer wearable cordless ring scanners for hands free barcode scanning. Extended warranty programs are available for all of our barcode scanning products. In 2013, our cordless barcode scanning revenue including accessories and service represented 62 percent of total revenue compared to 44 percent in 2012, and increased 63 percent over 2012.

### *Handheld Computers*

We offer a family of SoMo® (“Socket® Mobile”) handheld computer products in standard or antimicrobial cases running the Windows Embedded Handheld System 6.5 operating system. Handheld computer accessories include plug-in 1D and 2D barcode scanners, cradles, radio frequency identification (RFID) readers and magnetic stripe readers. Our handheld computers are designed with wireless LAN (802.11 b/g/n) and Bluetooth connectivity for use with applications that do not require phones. We also offer handheld computers without wireless connectivity for secure environments. Our newest family of handheld computers, SoMo Model 655, commenced sales in June 2012,

replacing the SoMo650 introduced in 2007. In 2013, our handheld computer revenue including accessories and service represented 34 percent of total revenue compared to 53 percent in 2012, and declined 26 percent from 2012.

—

2

## Table of Contents

### *Service*

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

### *OEM and Legacy Products*

We make available to original equipment manufacturers (“OEMs”) customized versions of our products. We also supply small quantities of discontinued legacy products on request when available. In 2013, our OEM and legacy product revenue represented 4 percent of our total revenue compared to 3 percent in 2012.

## **Developer Support Programs**

*Barcode Scanning.* We offer a barcode scanning software developer kit (“SDK”) to registered software application developers. Our barcode scanning SDK enables developers to easily integrate Socket’s SocketScan barcode scanning software into their applications. When integrated, the application owns the barcode scanner and controls its behavior. The SocketScan software works with smartphones, tablets and computers using operating systems from Apple (iOS), Google (Android), and Microsoft (Windows and Windows Mobile). We also support using the internal camera for barcode scanning. As of March 2014 we had more than 700 registered developers for our barcode scanning SDK including developers of third party applications and developers of in-house applications for businesses and we estimate more than 300 applications are in the market. The primary segments being addressed by registered developers are retail, commercial services, and healthcare.

*Handheld Computers.* Our SDK for the SoMo 655 handheld computer was introduced in the second half of 2012 and enables registered developers to avail themselves of features on our SoMo655 handheld computer that would not otherwise be accessible on the SoMo655 operating system, Windows Embedded 6.5. As of March 2014, we had more than 100 registered developers for our Handheld Computer SDK.

## **General**

Total employee headcount on December 31, 2013 was 48. We subcontract the manufacturing of all of our products to independent third-party contract manufacturers located in North America, Taiwan and other Asian countries that have the equipment, know-how and capacity to manufacture products to our specifications. Our handheld computers and

data collection products are sold through a worldwide network of distributors and resellers, vertical industry partners, and value added resellers. Our OEM products are sold directly to the original equipment manufacturers.

—

3

## Table of Contents

We were founded in March 1992 as Socket Communications, Inc. and reincorporated in Delaware in 1995 prior to our initial public offering in June 1995. We have financed our operations since inception primarily from the sale of equity capital or convertible debt and a receivables-based revolving line of credit with our bank. We began doing business as Socket Mobile, Inc. in January 2007 to better reflect our market focus on the mobile business market and changed our legal name to Socket Mobile, Inc. in April 2008. Our common stock trades on the OTC Market under the symbol “SCKT”. Our principal executive offices are located at 39700 Eureka Drive, Newark, CA 94560, and our phone number is (510) 933-3000. Our Internet home page is located at <http://www.socketmobile.com>; however, the information on, or that can be accessed through, our home page is not part of this Annual Report. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to such reports are available free of charge on or through our Internet home page, as soon as reasonably practical after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

## **Marketing Strategy and Dynamics**

*Capitalize on Strategic Relationships.* We actively promote software application developers to integrate our products into their applications through our developer support program. We provide easy to use software developer kits, training and technical support to our registered developers. We support the marketing activities of our registered developers in promoting the applications that include our products. Once our barcode scanning products are integrated into a developer application, our products become part of the application solution and we become part of the marketing program for that application. We stay current on operating system updates provided by Apple, Google and Microsoft to support new products running the latest versions of these operating systems on Smartphones, tablets and mobile computers while providing backward compatibility. We spend extensive engineering time and resources to ensure that our cordless barcode scanning products are compatible with a wide variety of the most popular smartphones, tablets and mobile computers running a variety of operating systems. We adhere to standards of a number of standards setting bodies whose technologies are used in our products including Bluetooth (both handheld computers and cordless barcode scanners) and wireless LAN (handheld computers).

*Markets.* The primary mobile barcode scanning markets we serve are retail and commercial services as described by Venture Development Corporation. We also serve to a lesser extent the healthcare market which is growing more slowly. We expect all three of these markets to increase the availability and use of mobile applications and the demand for mobile barcode scanners. Our SoMo handheld computers are used in many hospitality and healthcare applications.

*Expand and improve our product offerings.* We offer a wide range of products that enable developers and their customers to design their mobile systems to meet their specific requirements, and we encourage our distributors to support the full range of our products. The goal is for customers to view Socket as a primary source for their mobile barcode scanning needs. Within our family of barcode scanning products, we offer rugged and durable cases (the latter in multiple colors), linear imaging and laser barcode scanning, 2D barcode scanning, and two form factors: a

stand-alone cordless barcode scanner ergonomically designed to be held in the hand (our model 7 series) and our model 8 series designed to be attached to a Smartphone to enable one-handed barcode scanning or used as a stand-alone barcode scanner. We design our products to comply with the regulations of the many worldwide agencies that regulate the safety, performance and use of electronic products. For the SoMo family of handheld computers, we've upgraded the operating system and management software, adding many operating system features such as multiple language support, upgraded to later versions of the Windows (Mobile) embedded handheld operating system, and upgraded our Bluetooth and wireless LAN management software.

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4

## Table of Contents

*Price our products competitively and available worldwide.* We have designed our products to be priced competitively although we are subject from time to time to changes in component pricing by our suppliers. We distribute our products through a worldwide distribution network that places products into geographic regions to shorten purchasing times and provides a credit shield to us. Our largest distributors are Ingram Micro®, ScanSource® and BlueStar, and they support a worldwide network of electronic product resellers including Amazon®.com, CDW® and Barcodes, Inc.

*Build a Strong Brand Name.* We believe that our products make a difference in the daily work life of mobile workers and the people they serve. We are building a brand image focused on business mobility. This image closely associates us with business mobility solutions and to reflect this image, we began doing business as Socket Mobile, Inc. in January 2007 and changed our legal name to Socket Mobile, Inc. in April 2008. We stress with customers the design of our products for the markets they address, emphasizing quality and standards-based connectivity. Mobility requires products that are compact and designed to be handled while mobile, with low power consumption to extend time between charges, and easy to use. We strive to offer high performance products in a wide range of competitive prices. Through our developer support program, we work closely with application developers developing productivity enhancing applications for the mobile workforce. Our overall company brand identity and positioning goal is to be a leading provider of easy-to-deploy business mobility systems to the business mobility market.

## **Competition and Competitive Risks**

The overall market for mobile handheld computing solutions is both complex and competitive. Our hardware products compete with similar hardware products in all of our markets in the United States, Europe and Asia. Our longtime focus on creating innovative mobile solutions for the mobile workforce has resulted in good brand name recognition and reputation. We believe that our brand name identifies our products as durable, dependable, small form factor, low power and easy to use, all features designed for a mobile worker while mobile, and the breadth of our product offerings, including the extensive features of our software and software developer kits, will continue to differentiate us relative to our competitors.

*Cordless Barcode Scanning.* We offer a full range of stand-alone cordless barcode hand scanners connecting to smartphones, tablets and other computing devices over Bluetooth. Our SocketScan Software Developer Kit enables registered third party application developers to integrate the features of our SocketScan software into their applications and helps differentiate our products. We face competition from products similar to our cordless hand scanners from Koamtec, Code Corporation, and Opticon (Japan). Users of smartphones and tablets may also scan barcodes with their camera phone, although the process is much slower than with our products and larger devices such as tablets may be difficult to position to obtain a barcode scan. Users may choose a barcode scanner that connects with a wire directly to an Apple tablet, iPhone or computer such as offered by Infinite Peripherals and Honeywell. Users also may choose more rugged barcode scanners as an alternative, some of which are integrated into computing devices from manufacturers such as Datalogic, Honeywell®, LXE (acquired by Honeywell), Intermec® (acquired by

Honeywell), Motorola® Solutions and Psion Teklogix (acquired by Motorola). These devices are not Apple certified. They will connect over Bluetooth, but don't offer extensive tools for software developers such as our software developer kit to integrate features of our sophisticated barcode scanning software SocketScan into barcode scanning applications.

—  
5



Table of Contents

*Handheld Computers.* A number of larger, well financed companies manufacture handheld mobile computers. Most of the manufacturers offer only ruggedized systems that are higher priced and larger than our devices but are capable of running the same applications. Many of these systems have built in barcode scanners, are larger, heavier and more expensive, so do not directly compete with our products but are an alternative. These companies include Datalogic, Honeywell, LXE (acquired by Honeywell), Intermec (acquired by Honeywell), Motorola Solutions and Psion Teklogix (acquired by Motorola). Consumer grade products (durable rather than rugged) also provide competitive alternatives to our products. These companies include Bluebird (selling under the brand name Pidion), Unitek and Janam and some of their products include integrated barcode scanners.

Our SoMo655 handheld computer's operating system is Windows Embedded Handheld 6.5. Microsoft recently announced it would continue to support version 6.5 until early 2020 which was designed to assure users of products running this version of a long period of continued support. Microsoft also announced Windows Mobile 8 Embedded, a superset of their phone operating systems for devices having phones and integrated barcode scanners. Windows Mobile 8 Embedded does not apply to our category of handheld computer which has neither a phone nor an integrated barcode scanner as our customers typically operate over wireless LAN and Bluetooth connections within the walls of their organization and do not require a phone. We do not directly compete with devices running Windows Mobile 8 Embedded but they can become competitive alternatives where a phone and an integrated scanner are needed.

Sales of our handheld computer family of products, the SoMo650, introduced in 2007 and replaced in 2012 with the SoMo655, are designed as a close replacement for classic PDAs such as the Hewlett-Packard Series 200 family of handheld computer products that were discontinued by Hewlett-Packard in 2011. We have enhanced our product offerings with a software developer kit that enables registered developers to avail themselves of features on our SoMo655 handheld computer that would not otherwise be accessible under the Windows Embedded 6.5 operating system. More than 75,000 SoMo handheld computers have been sold since 2007.

**Proprietary Technology and Intellectual Property**

We have developed a number of technological building blocks that enhance our ability to design new hardware and software products, to offer products which run on multiple software and hardware platforms, and to manufacture and package products efficiently.

We own and control the design of our barcode scanners and our SoMo handheld computer, enabling us to modify its features or software to meet specific customer requirements.

Another area of intellectual property is our expertise in embedded radio-dependent firmware. Within our Bluetooth cordless products are software and firmware that include a wide variety of functions to enable efficient radio control and overall systems functionality. For cordless barcode scanning this includes our patented Error Proof Protocol, which is designed to ensure that scanned data is correctly received by the mobile computing device and allows for real-time validation of data and error notification to the user. We have developed SocketScan barcode scanning software that allows our products to communicate with applications on Smartphones and tablets running operating systems from Apple (iOS), Google (Android), and Microsoft (Windows and Windows Mobile). We hold twenty-nine U.S. patents and ten design patents covering various inventions that relate to mobile products and to the design of our products. We have other patent applications undergoing review.

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6

Table of Contents

We have developed a number of software programs that provide unique functions and features for our handheld computer and cordless barcode scanning products. For example, our SocketScan software enables all of our barcode scanning products to scan a variety of barcodes and to route the scanned data to many different types of data files on a number of operating systems used in mobile devices. Our Bluetooth software used in conjunction with our Bluetooth hardware provides a completely functional Bluetooth solution enabling connections and data transfers between Bluetooth-enabled devices. Our wireless local area network software called Enhanced Wi-Fi Companion provides an extensive set of features to help the user get and stay connected. This software program used in conjunction with our handheld computers provides a completely functional wireless local area network solution, enabling connections and data transfers from and to our mobile computers over wireless local area networks. In addition, our Bluetooth and wireless LAN software programs are aligned to insure optimal performance even when both technologies are being utilized at the same time.

We have registered trademarks with the U.S. Patent and Trademark Office for the mark “Socket”, our logo, the terms “Go-WiFi” and “Battery Friendly” and “SoMo”, the mark associated with our mobile handheld computers.

We rely on a combination of patent, copyright, trademark and trade secret laws, and confidentiality procedures to protect our proprietary rights. As part of our confidentiality procedures, we generally enter into non-disclosure agreements with our employees, distributors and strategic partners, and limit access to our software, 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 or technology without authorization, or to develop similar technology independently. In addition, we may not be able to effectively protect our intellectual property rights in certain foreign countries. From time to time we receive communications from third parties asserting that our products infringe, or may infringe, their proprietary rights. In connection with any such claims, litigation could be brought against us that could result in significant additional expense or compel us to discontinue or redesign some of our products.

**Personnel**

Our future success will depend in significant part upon the continued service of certain of our key technical and senior management personnel, and our continuing ability to attract, assimilate and retain highly qualified technical, managerial and sales and marketing personnel. Our total employee headcount as of December 31, 2013 was 48. Our employees are not represented by a union, and we consider our employee relationships to be good. As of December 31, 2013, we had 12 persons in sales and marketing and customer service, 9 persons in development engineering, 8 persons in finance and administration, and 19 persons in operations.

Table of Contents

**Item 1A. Risk Factors**

**Our ability to continue as a going concern is dependent upon our ability to establish ongoing profitable operations and to raise additional capital.**

Our historical operating losses and declines in our working capital balances are conditions that raise substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern is dependent upon our ability to maintain ongoing profitable operations and to raise additional capital as needed. We have been taking steps intended to improve operating results and achieve future profitability including the introduction of new products, continued close support of our distributors and of our application partners as they establish their mobile applications in key vertical markets, and management of our costs. We believe that we will be able to improve our liquidity and secure additional sources of financing by managing our working capital balances, use of our bank lines of credit, and raising additional capital as needed including development funding from development partners and the issuance of additional equity securities. Nonetheless, there can be no assurance that we will be successful in achieving any of these steps, and there can be no assurance that additional financing will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. Our inability to secure and maintain the necessary liquidity would have a material adverse effect on our financial condition and results of operations. Our financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of assets and liabilities that may result from our inability to continue as a going concern.

**We have a history of operating losses and may not achieve ongoing profitability.**

We were profitable in each of the first two quarters in 2013, but unprofitable in the third and fourth quarters, and unprofitable in total for fiscal 2013. Fiscal year 2004 was the only profitable year in our history, and only to the extent of \$288,000. Prior to 2004, we incurred significant operating losses in each financial period since our inception. To achieve ongoing profitability, we must accomplish numerous objectives, including growth in our business 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 achieve ongoing profitability. If we cannot achieve 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 your stock holdings.**

We may incur operating losses in future quarters and would need to raise capital to fund such losses. 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 handheld computers and our data collection 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.

—  
8

Table of Contents

**Global economic conditions may continue to 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.**

Continued tight credit and related strains in the global financial system, particularly in Europe, may continue to have an impact on our business and our financial condition. We may face significant challenges if economic conditions and conditions in the financial markets do not improve or continue to worsen. In particular, should these conditions cause our revenues to be materially less than forecast, we may find it necessary to initiate further 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.

**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.

Table of Contents

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

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

Our credit agreements with our bank requires us to maintain cash and qualified receivables that are at least two times amounts borrowed and outstanding under the credit agreements. The agreements contain customary representations, warranties, covenants and events of default that limit our ability to incur additional liens or indebtedness, make distributions to our stockholders and make investments. The events of default entitle our bank to accelerate our obligations and require repayment of our outstanding indebtedness thereunder. These events of default include a breach of our payment obligations or covenants, a material impairment in our financial condition or ability to repay any indebtedness to our bank and the commencement of dissolution or insolvency proceedings. 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. Our bank has been granted a first priority security interest in all of our assets, including our intellectual property.

**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, including our barcode scanning modules, and our line of mobile handheld computers, 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.

—

10



Table of Contents

**If third-parties do not produce and sell innovative products with which our products are compatible, we may not achieve our sales projections.**

Our success has been dependent upon the ability of third-parties in the mobile computing industry to successfully develop applications and products that include or are compatible with our technology, and then to sell these applications and products into the marketplace. Even if we are successful in marketing and selling our line of scanners and mobile handheld computers, our ability to generate increased revenue depends significantly on the commercial success of other parties' applications and products, particularly vertical market software applications for use with our scanners and mobile handheld computers and peripherals, and tablet computers and phone-integrated devices including those from Apple, Google, and Microsoft, with which our scanners can be used, and the adoption of mobile applications and computing devices for business use.

A number of manufacturers of handheld computers have reduced the number of handheld products they offer, or curtailed development of future handheld computer products, reducing the number of third-party devices compatible for use with our mobile handheld computer peripheral plug-in products. Sales of standard handheld computing devices such as our mobile handheld computer have been declining due to the increased popularity of alternative tablet and smartphone devices, and sales of our mobile handheld computer and related peripheral plug-in products may continue to decline in the future.

**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 software and scanning 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 barcode scanners 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 that may limit their success, 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.

**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 conforming 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.

—

11

Table of Contents

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 expose our products to the risk of obsolescence and require frequent new product 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 fiscal years 2013 and 2012, Ingram Micro Inc., ScanSource, Inc., and BlueStar, Inc. together represented approximately 55% and 48%, 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 Ingram Micro Corporation or ScanSource, Inc., or any of our other significant distributors, we would experience disruption and delays in marketing our products.

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

Our accounts receivable are derived primarily from distributors and OEMs. 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. Current global financial conditions may 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.

Table of Contents

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

The market for mobile handheld computers 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, mobile phones and handheld computers offer products with built-in functions, such as Bluetooth wireless technology, Wi-Fi, 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. We expect that it will become more difficult to forecast demand given current economic conditions, as we introduce and support more products, and as competition in the markets for our products intensifies. If demand is lower than forecasted levels, 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, resellers, vertical industry partners, and OEMs to sell our products, and our sales would suffer if any of these third-parties stops selling our products effectively.**

Because we sell our products primarily through distributors, resellers, vertical industry partners, and OEMs, 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.

—

13

Table of Contents

Our agreements with distributors, resellers, vertical industry partners, and OEMs are generally nonexclusive and may be terminated on short notice by them without cause. Our distributors, resellers, vertical industry partners, and OEMs 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 a small number of third-parties, and a disruption in any one of 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 communications and mobile handheld computer markets 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 Windows Mobile, Windows CE, Windows 7/Vista/XP, Windows Embedded Handheld, Apple, Google's Android, RIM Blackberry, and to develop our own family of mobile handheld computers. 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 Microsoft, Apple, Google or Research In Motion 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.

Table of Contents

**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.

—

15



Table of Contents

**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 nineteen to twenty-one years by us, including our President, Chief Financial Officer, and 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 and may continue to cause us to incur net losses 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.

—

16

Table of Contents

**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.**

Export sales (sales to customers outside the United States) accounted for approximately 30% and 40% of our revenue in fiscal years 2013 and 2012, respectively. Accordingly, 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 United States dollars and in Euros for our sales to European distributors. Accordingly, an increase in the value of the United States dollar relative to foreign currencies could make our products more expensive and therefore potentially less competitive in foreign markets. 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. Furthermore, the recent economic instability of the Eurozone could have a material adverse affect on our business, including the ability of our distributors to sell our products and our ability the collect the related Euro receivables.



Table of Contents

**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.

**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 March 21, 2014, we had 4,904,563 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 March 21, 2014, we had 1,850,183 shares of common stock subject to outstanding options under our stock option plans, and 219,567 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.

—

18

Table of Contents

As of March 21, 2014, we had 57,776 shares of common stock subject to outstanding warrants issued in our 2009 private placement. We have registered the resale of all shares of common stock subject to the warrants. Accordingly, the shares of common stock underlying these warrants will be eligible for resale in the public market as soon as the warrants are exercised, subject to S-3 prospectus delivery requirements.

As of March 21, 2014, we had 976,000 shares of common stock subject to outstanding warrants issued in connection with the convertible note financing in November 2010. We have registered the resale of all shares of common stock subject to the note conversion and warrants. Accordingly, the shares of common stock underlying the note and warrants will be eligible for resale in the public market as soon as the note is converted and the warrants are eligible and exercised, subject to S-3 prospectus delivery requirements.

As of March 21, 2014, we had \$777,625 in subordinated convertible notes payable. Up to 991,914 shares of common stock could be issued for conversion of the notes plus all accrued interest thru the maturity dates of August 1, 2014 and September 4, 2017.

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

During the period from January 1, 2013 through March 21, 2014, our common stock price fluctuated between a high of \$2.20 and a low of \$0.70. On July 30, 2012, our common stock was delisted from the Nasdaq market and began trading on the Over-the-Counter Marketplace. 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.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

We lease a 37,100 square foot office facility in Newark, California under a lease expiring in June 2022. This facility houses our headquarters and manufacturing operations, and is used by all segments of the Company. We believe that our current facilities are sufficient and adequate to meet our needs for the foreseeable future.

—

19



Table of Contents

**Item 3. Legal Proceedings**

We are currently not a party to any material legal proceedings.

**Item 4. Mine Safety Disclosures**

Not applicable.

**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

**Common Stock**

The Company's common stock is traded on the OTCQB Marketplace under the symbol "SCKT."

The quarterly high and low sales prices of our common stock, as reported on the OTCQB Marketplace through March 21, 2014 and for the last two fiscal years are as shown below:

<b>Quarter Ended</b>	<b>Common Stock</b>	
<b><u>2012</u></b>	<b>High</b>	<b>Low</b>

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March 31, 2012	\$3.90	\$1.87
June 30, 2012	\$2.60	\$1.95
September 30, 2012	\$2.25	\$0.96
December 31, 2012	\$1.43	\$0.85
<u>2013</u>		
March 31, 2013	\$1.89	\$0.70
June 30, 2013	\$2.20	\$0.92
September 30, 2013	\$1.98	\$1.12
December 31, 2013	\$1.45	\$0.70
<u>2014</u>		
March 31, 2014 (through March 21, 2014)	\$1.14	\$0.70

On March 21, 2014, the closing sales price for our common stock as reported on the OTCQB Marketplace was \$0.93. We had approximately 3,400 beneficial stockholders of record as of March 17, 2014. We have not paid dividends on our common stock, and we currently intend to retain future earnings for use in our business and do not anticipate paying dividends in the foreseeable future.

The information required by this item regarding equity compensation plans is incorporated by reference to the information set forth in Item 12 of this Annual Report on Form 10-K.

Table of Contents

**Performance Graph**

The performance graph shown below shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities under that section, and shall not be deemed to be incorporated by reference into any filing of Socket Mobile, Inc. under the Securities Act of 1933, as amended, or the Exchange Act. The performance graph below shows a five-year comparison of cumulative total stockholder return, calculated on a dividend reinvestment basis and based on a \$100 investment, from December 31, 2008 through December 31, 2013 comparing the return on the Company's common stock with the Russell 2000 Index and the NASDAQ Computer & Data Processing Index. No dividends have been declared or paid on the common stock during such period. Historical stock price performance is not necessarily indicative of future stock price performance.

Table of Contents**Item 6. Selected Financial Data**

The following selected financial data should be read in conjunction with Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and the financial statements and the notes thereto in Item 8, “Financial Statements and Supplementary Data.”

(Amounts in thousands except per share)	Years Ended December 31,				
	2009(a)	2010(c)	2011(c)	2012	2013
<b>Income Statement Data:</b>					
Revenue	\$17,127	\$13,498	\$17,511	\$13,565	\$15,661
Gross profit	\$7,374	\$5,401	\$7,250	\$5,047	\$6,303
Operating expenses	\$15,702	\$9,116	\$8,524	\$8,056	\$6,426
Net loss	\$(7,889 )	\$(3,976 )	\$(2,422 )	\$(3,298 )	\$(620 )
Net loss per common share:					
	\$(2.21 )	\$(1.05 )	\$(0.56 )	\$(0.68 )	\$(0.13 )
Basic and diluted					
<b>Weighted average shares outstanding:</b>					
Basic and diluted	3,562	3,796	4,360	4,854	4,865
<b>At December 31,</b>					
	2009	2010	2011	2012	2013
<b>Balance Sheet Data:</b>					
Cash and cash equivalents	\$1,940	\$461	\$957	\$391	\$606
Restricted cash (b)	\$—	\$711	\$—	\$—	\$—
Total assets	\$11,743	\$9,067	\$10,397	\$7,921	\$8,102
Bank line of credit	\$1,002	\$—	\$1,110	\$811	\$764
Senior convertible note (b)	\$—	\$330	\$—	\$—	\$—
Related party subordinated convertible note	\$—	\$—	\$—	\$750	\$650
Short term subordinated note	\$—	\$—	\$—	\$95	\$778
Capital leases and deferred rent - long term portion	\$97	\$202	\$184	\$227	\$265
Total stockholders’ equity	\$5,388	\$2,893	\$3,126	\$469	\$133

(a) Amounts for 2009 include goodwill impairment charges of \$5.4 million recorded as of December 31, 2009.

(b) Under the terms of the senior convertible note financing closed in November 2010, the Company was required to set aside cash collateral to the extent qualified accounts receivables are less than the note plus interest. At

December 31, 2010, the cash collateral requirement was \$0.7 million. At December 31, 2010 the amount shown as the Company's senior convertible note, represents the \$1.0 million face value of the note net of debt discount of \$0.67 million. The note was subsequently called by the Company in August 2011, and the note holder completed full conversion of the note to common stock by September 2011.

In the years ended December 31, 2010 and 2011, the net loss includes non-cash charges to interest expense of (c) approximately \$56,000 and \$1,050,000, respectively, related to the Company's senior convertible note closed in November 2010 (see item (b) discussed immediately above).

Table of Contents

**Item 7. Management’s Discussion and Analysis of Financial Condition and Results  
of Operations**

**Liquidity and Going Concern**

During the years ended December 31, 2013 and 2012, we incurred net losses of \$0.6 million and \$3.3 million, respectively. As of December 31, 2013, we have an accumulated deficit of \$61.1 million. Our cash balances at December 31, 2013 were \$0.6 million, including \$0.8 million advanced on our bank lines of credit. At December 31, 2013, we had additional unused borrowing capacity of approximately \$0.1 million on our bank lines of credit. Our balance sheet at December 31, 2013 has a current ratio (current assets divided by current liabilities) of 0.4 to 1.0, and a working capital deficit of \$4.3 million (current assets less current liabilities). These circumstances raise substantial doubt about our ability to continue as a going concern.

We have taken actions to reduce our expenses and to align our cost structure with economic conditions. We have the ability to further reduce expenses if necessary. Steps taken by us intended to reduce operating losses and achieve profitability include reduction of headcount to manage payroll costs, the introduction of new products, and continued close support of our distributors and our application development partners as they establish their mobile applications in key vertical markets. We extended the maturity dates on our convertible notes originally issued in 2012 (see NOTE 2 — Related Party Convertible Notes Payable” for more information). We completed additional financing in 2013 (see “NOTE 3 — Related Party and Other Short-Term Notes Payable” for more information). We believe that we will be able to further improve our liquidity and secure additional sources of financing by managing our working capital balances, use of our bank lines of credit, and raising additional capital as needed including development funding from development partners and the issuance of additional equity securities. However, there can be no assurance that additional capital will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. Our new bank line of credit may be terminated by the bank or by us at any time (see “NOTE 4 – Bank Financing Arrangements”). If we cannot attain 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 for our business, we may need to suspend some or all of our current operations.

If we can return to revenue growth and attain profitability, we anticipate requirements for cash will include funding of higher receivable and inventory balances, and increased expenses, including an increase of costs relating to new employees to support our growth and increases in salaries, benefits, and related support costs for employees.

Critical Accounting Policies

Our significant accounting policies are described in Note 1 to our financial statements for the years ended December 31, 2013 and 2012. The application of these policies requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on a combination of historical experience and reasonable judgment applied to other facts. Actual results may differ from these estimates, and such differences may be material to the financial statements. In addition, the use of different assumptions or judgments may result in different estimates. We believe our critical accounting policies that are subject to these estimates are: Revenue Recognition and Accounts Receivable Reserves, Inventory Valuation, Stock Based-Compensation, and Valuation of Goodwill and Other Intangible Assets.

—

23

## Table of Contents

### Revenue Recognition and Accounts Receivable Reserves

We defer revenue recognition on products sold to distributors until our distributors sell the products to their customers, because our distributors generally have limited rights to return products to us for stock rotation, stock reduction, or replacement of defective product. The amount of deferred revenue net of related cost of revenue is classified as deferred income on shipments to distributors on our balance sheet. We use inventory reports received from our distributors at the end of each reporting period to determine the extent of inventory at the distributor, and thus, the amount of income to defer. Stock rotation and stock reduction from our distributors generally results in a balance sheet adjustment to our deferred income and does not impact our revenue or cost of revenue.

We generally recognize revenues on sales to customers other than distributors upon shipment provided that persuasive evidence of a sales arrangement exists, the price is fixed and determinable, title has transferred, collection of resulting receivables is reasonably assured, there are no customer acceptance requirements, and there are no remaining significant obligations. Most of our customers other than distributors do not have rights of return except under warranty.

We also earn revenue from an extended warranty service program offered on select products. Revenues from the extended warranty service program are recognized ratably over the life of the extended warranty contract. The amount of unrecognized warranty service revenue is classified as deferred service revenue and presented on our balance sheet in its short and long-term components. We also earn revenue from services performed in connection with consulting arrangements. For those contracts that include contract milestones or acceptance criteria we recognize revenue as such milestones are achieved or as such acceptance occurs. In some instances the acceptance criteria in the contract requires acceptance after all services are complete and all other elements have been delivered, in which case revenue recognition is deferred until those requirements are met.

We estimate the amount of uncollectible receivables at the end of each reporting period based on the aging of the receivable balance, historical trends, and communications with our customers. If actual bad debts are significantly different from our estimates our operating results will be affected.

### *Inventory Valuation*

Our inventories primarily consist of component parts used to assemble our products after we receive orders from our customers. We purchase or have manufactured the component parts required by our engineering bill of materials. The timing and quantity of our purchases are based on order forecasts, the lead time requirements of our vendors, and on economic order quantities. At the end of each reporting period, we compare our inventory on hand to our forecasted requirements for the next nine-month period, and write off the cost of any inventory that is surplus, less any amounts that we believe we can recover from disposal of goods that we specifically believe will be saleable past a nine-month horizon. Our sales forecasts are based upon historical trends, communications from customers, and marketing data



regarding market trends and dynamics. Surplus or obsolete inventory can also be created by changes to our engineering bill of materials. Charges for the amounts we record as surplus or obsolete inventory are included in cost of revenue.

—  
24

Table of Contents

*Stock-Based Compensation*

We account for share-based awards to employees, including grants of employee stock options, in our financial statements based on the grant date fair values of the share-based awards. We use a binomial lattice valuation model to estimate the fair value of stock option grants. The binomial lattice model incorporates calculations for expected volatility, risk-free interest rates, employee exercise patterns and post-vesting employment termination behavior, and these factors affect the estimate of the fair value of the stock option grants.

Valuation of Goodwill

Goodwill is tested for impairment at least annually as of September 30th and between annual tests if indicators of potential impairment exist. We test goodwill for impairment at the reporting unit level. Prior to performing the goodwill impairment test we determine whether any triggering events are present that could cause impairment of goodwill. We then perform a two-step test to assess goodwill for impairment. The first step of the goodwill impairment test requires a determination of whether the fair value of the reporting unit is less than its carrying value. If the fair value exceeds the carrying value, goodwill is not impaired and no further testing is performed. The second step is performed only if the carrying value exceeds the fair value. The second step involves an analysis reflecting the allocation of fair value determined in the first step (as if it was the fair value of the consideration transferred in a business combination). This process may result in the determination of a new amount of goodwill. If the implied fair value of the goodwill resulting from this hypothetical acquisition accounting is lower than the carrying value of the goodwill in the reporting unit, the difference is reflected as a non-cash impairment loss. The purpose of the second step is only to determine the amount of goodwill that should be recorded on the balance sheet. The recorded amounts of other items on the balance sheet are not adjusted. We have determined that we have one reporting unit for purposes of goodwill testing.

If the carrying value of the reporting unit is zero or negative, the second step of the impairment test, as described above, is required to be performed to measure the amount of impairment loss, if any, when it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, we are required to evaluate whether there are adverse qualitative factors. We believe adverse qualitative factors exist as of December 31, 2013, based on the Company's continued reported losses from operations. As of December 31, 2013, the carrying value of the Company's reporting unit is \$133,000.

We estimate the fair value of our reporting unit utilizing up to three valuation methods: market capitalization, income approach and market approach. Revenue and expense forecasts used in the evaluation of goodwill are based on trends of historical performance and our estimate of future performance. We determined that the fair value of the Company's reporting unit at September 30, 2013, the date of the Company's annual impairment test, exceeded its carrying value and as a result, goodwill is considered not impaired. Furthermore, we determined there were no indicators of impairment in the subsequent fourth quarter 2013.

Table of Contents**Revenues**

Our revenues have been classified into two primary product families for the years ended December 31, 2013 and 2012. Additionally, we sell OEM embedded products to third parties, and we continue to carry legacy plug-in connectivity products. Our product revenues are presented in the following table:

(revenues in thousands)	Years ended December 31,				% Increase (Decrease) 2013 vs. 2012
	2013		2012		
Product family:	\$'s	%'s	\$'s	%'s	
Cordless barcode scanning and related products and service	\$9,747	62 %	\$5,953	44 %	63 %
Mobile handheld computer and related products and service	5,287	34 %	7,187	53 %	(26 %)
Other	627	4 %	425	3 %	53 %
Total	\$15,661	100 %	\$13,565	100 %	15 %

Our *cordless barcode scanning and related products and service* revenues in 2013 were \$9.7 million, an increase of \$3.8 million or 63%, from cordless barcode scanning and related revenues in 2012. Revenue increases in 2013 of \$2.8 million were from increased sales volumes of our Series-C entry level Apple certified cordless handheld barcode scanning products, and revenue increases of \$0.6 million were due to increased sales volumes of our Apple certified imager based cordless handheld scanner model 7Xi. Remaining revenue increases were due to increased sales volumes of our other cordless handheld scanning models and accessories, partially offset by slight declines in sales volumes of our cordless ring scanner.

Our *mobile handheld computer and related products and service* revenues in 2013 were \$5.3 million, a decline of \$1.9 million or 26%, from mobile handheld computer and related product revenues in 2012. Mobile handheld computer revenues (excluding revenues from the related plug-in products, accessories, and services) declined by \$1.8 million

reflecting lower overall sales volumes of our next generation SoMo 655 models compared to our previous SoMo 650 models in effect in the same period one year ago. We commenced shipping our next generation mobile handheld computers into our distribution channel beginning in June 2012. Product transitions such as this tend to slow customer deployments because of the time needed by customers and integrators to evaluate and qualify the new models with their applications. The transition to the new models of our standard mobile handheld computer was substantially completed in the third quarter 2012 with the last shipments of available units of the older models. Additionally, sales of our new SoMo 655 models have been affected by the uncertainty surrounding Microsoft's support of the Windows Embedded Handheld 6.5 operating system, which they clarified in mid 2013 by their announced commitment to this operating system until early 2020. Remaining declines in 2013 were from declines in sales of our companion plug-in data collection products due primarily to lower sales volumes of CompactFlash plug-in barcode scanners, and from reduced sales of SocketCare and warranty services, reflective of the overall lower unit sales volumes of our mobile handheld computers in 2013 compared to 2012. Partially offsetting these declines in companion plug-in sales and SocketCare and warranty service sales, were increased sales of our mobile handheld computer related accessories.

## Table of Contents

Service revenues were \$0.6 million or 4% of our revenues in 2013 and \$0.8 million or 6% of our revenues in 2012. Declines in service revenues in 2013 reflect the declines in unit sales of our mobile handheld computers in 2013 compared to 2012. The majority of our SocketCare service contracts are purchased by our customers in conjunction with the purchase mobile handheld computers. Service revenues have been allocated to the respective products serviced in the table above.

Other revenues in 2013 were \$0.6 million, an increase of \$0.2 million or 53%, from other revenues in 2012. Revenues in 2013 were primarily related to one-time buys of legacy products including our Bluetooth modules and wireless LAN plug-in cards primarily within the first half of 2013 by OEM customers.

## **Gross Margins**

Gross margins for 2013 were 40% of revenues compared to gross margins of 37% in 2012. We generally price our products as a markup from our cost, and we offer discount pricing for higher volume purchases. Improvements in overall margins in 2013 are due primarily to a change in mix of products sold favoring a greater proportion of sales of our cordless handheld barcode scanner models which overall have slightly higher than average margins, and a lower proportion of sales of our mobile handheld computers which have slightly lower than average margins. Additional margin improvements were due to reduced overhead costs in 2013 compared to a year ago.

## **Research and Development Expense**

Research and development expense in 2013 was \$2.3 million, a decline of 16% from research and development expense in 2012 of \$2.7 million. Reductions of \$0.3 million in 2013 compared to 2012, were due to reductions in personnel costs as a result of declines in headcount levels in the comparable periods and lower stock compensation expense reflecting higher cost grants becoming fully vested. Remaining declines in research and development expense were from lower levels of outside development activities in 2013 compared to 2012, reflecting in 2012 the completion of the development of our next generation SoMo series of mobile handheld computers.

## **Sales and Marketing Expense**

Sales and marketing expense in 2013 was \$2.3 million, a decrease of 31% compared to sales and marketing expense in 2012 of \$3.4 million. Decreases in sales and marketing expense of \$0.8 million in 2013 were due to declines in

personnel costs due primarily to lower overall comparable headcount. Remaining declines in 2013 were due to declines in advertising and promotional costs, and reductions in travel related expense.

### **General and Administrative Expense**

General and administrative expense in 2013 was \$1.9 million, a decline of 7% compared to general and administrative expense of \$2.0 million in 2012. Declines in general and administrative expense in 2013 were due primarily to lower stock compensation expense reflecting higher cost grants becoming fully vested. Expense declines in 2013 were partially offset by increased occupancy costs compared to the prior year.

Table of Contents

**Interest Expense and Other, net of Interest Income and Other**

Interest expense and other, net of interest income and other, was \$466,000 in 2013 compared to \$257,000 in 2012. Interest expense in 2013 was related primarily to interest on amounts advanced under short term credit agreements, interest on amounts drawn on our bank lines of credit, interest on our convertible notes payable issued in 2012 and reissued in August of 2013, and interest on our notes payable (see “NOTE 2 — Related Party Convertible Notes Payable” and “NOTE 3 — Related Party and Other Short Term Notes Payable” for more information). Interest expense in 2012 was related primarily to interest on amounts drawn on our bank lines of credit, interest on our short term loan advanced on August 31, 2012, and interest on our convertible notes payable issued in 2012 as discussed immediately above. Additionally, interest expense in each of the comparable periods includes interest on equipment lease financing obligations. Additionally, interest expense includes interest on equipment lease financing obligations in each of the two years presented.

Interest income and other, reflects interest earned on cash balances. Interest income in 2013 and 2012, was nominal, reflecting low average cash balances combined with low average rates of return. Other income and expense includes foreign currency transaction gains and losses, which were nominal in each of the periods presented.

**Income Taxes**

Deferred tax expense of \$32,000 in 2013 and 2012, and the corresponding deferred tax liability shown on our balance sheet, is related entirely to the deferred tax liability on the portion of our goodwill amortized for tax purposes. Due to the indefinite characteristic of this deferred tax liability, it cannot be offset against deferred tax assets. We maintain a full valuation allowance for all other components of deferred tax assets. There can be no assurance that the deferred tax assets subject to the valuation allowance will be realized. We have not generated taxable income in any periods in any jurisdiction, foreign or domestic.

**Quarterly Results of Operations**

The following table sets forth summary quarterly statements of operations data for each of the quarters in 2012 and 2013. This unaudited quarterly information has been prepared on the same basis as the annual information presented elsewhere herein, and, in our opinion, includes all adjustments (consisting only of normal recurring entries) necessary for a fair presentation of the information for the quarters presented. The operating results for any quarter are not necessarily indicative of results for any future period.





Table of Contents

(amounts in thousands, except per share amounts)	Quarter Ended (unaudited)							
	Mar 31,	Jun 30,	Sep 30,	Dec 31,	Mar 31,	Jun 30,	Sep 30,	Dec 31,
	<u>2012</u>	<u>2012</u>	<u>2012</u>	<u>2012</u>	<u>2013</u>	<u>2013</u>	<u>2013</u>	<u>2013</u>
<b>Summary Quarterly Data:</b>								
Revenue	\$3,954	\$4,038	\$2,796	\$2,777	\$4,265	\$4,435	\$3,292	\$3,669
Cost of revenue	2,431	2,539	1,814	1,734	2,557	2,631	2,009	2,161
Gross profit	1,523	1,499	982	1,043	1,708	1,804	1,283	1,508
Operating expenses:								
Research and development	784	740	635	552	525	594	578	573
Sales and marketing	960	982	798	632	559	585	499	684
General and administrative	613	497	454	409	461	449	395	524
Total operating expenses	2,357	2,219	1,887	1,593	1,545	1,628	1,472	1,781
Interest income (expense), net	(30 )	(27 )	(70 )	(130 )	(80 )	(125 )	(124 )	(137 )
Deferred tax expense(benefit)	8	8	8	8	8	8	8	8
Net income (loss)	\$(872 )	\$(755 )	\$(983 )	\$(688 )	\$75	\$43	\$(321 )	\$(418 )
Basic and diluted net income (loss) per share	\$(0.18 )	\$(0.16 )	\$(0.20 )	\$(0.14 )	\$0.02	\$0.01	\$(0.07 )	\$(0.09 )

We have experienced significant quarterly fluctuations in operating results, and we anticipate such fluctuations to continue in the future. We generally ship orders as received and therefore quarterly revenue and operating results depend on the volume and timing of orders received during the quarter, which are difficult to forecast. Historically, we have recognized a substantial portion of our revenue in the last month of the quarter. Operating results may also fluctuate due to factors such as the demand for our products, the size and timing of customer orders, the introduction of new products and product enhancements by us or our competitors, product mix, timing of software enhancements, manufacturing supply shortages, changes in the level of operating expenses, and competitive conditions in the industry. Because our staffing and other operating expenses are based on anticipated revenue, a substantial portion of which is not typically generated until the end of each quarter, delays in the receipt of orders can cause significant variations in operating results from quarter to quarter.

**Cash Flows and Contractual Obligations**

As reflected in our Statements of Cash Flows, net cash used in operating activities in 2013 was \$0.1 million, compared to \$0.9 million used in operating activities in 2012. We calculate net cash used in operating activities by

reducing our net loss (\$0.6 million and \$3.3 million in 2013 and 2012, respectively), by those expenses that did not require the use of cash, and reversing gains that did not generate cash. These items consist of stock based compensation expense, depreciation, amortization of intangible assets, deferred tax expense, and in 2013, the fair value of common stock issued in conjunction with a litigation settlement. These amounts totaled \$0.6 million and \$1.0 million in 2013 and 2012, respectively. Decreases in non-cash charges in 2013 were primarily from reduced stock-based compensation expense reflecting older higher priced grants becoming fully vested and overall reductions in headcount in 2013 compared to 2012. 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.

—

29

Table of Contents

In 2013, changes in operating assets and liabilities resulted in a net use of cash of \$65,000 and were primarily from reductions in accounts payable due to increased payments to suppliers and vendors, increases in inventory levels, and declines in deferred service revenues reflecting the reduced sales volumes of our handheld computer in 2013, which comprise a larger portion of our SocketCare service revenues. Partially offsetting these uses of cash were increases in deferred income on shipments to distributors due to higher levels of inventory in our distribution channel, increases in accrued payroll, and declines in accounts receivable. In 2012, changes in operating assets and liabilities resulted in a net source of cash of \$1.4 million and were primarily from reductions in accounts receivable due to lower levels of shipments in the fourth quarter 2012 compared to the fourth quarter 2011 due primarily to declines in shipments of our mobile handheld computer products as we completed the transition from our older devices to our next generation models in late 2012, reductions in our inventory levels in 2012 due to depletion of stock of our older mobile handheld computer models, and increases in accounts payable due to deferred payments at year end. These sources of cash were partially offset by decreases in deferred income on shipments to distributors as a result of reductions in overall distributor inventory levels due to the depletion in their stocks of the older mobile handheld computer models mentioned previously, and lower overall inventory levels carried by our distributors in response to lower revenue levels in late 2012.

Cash used in investing activities was \$159,000 in 2013 and \$235,000 in 2012. Investing activities in 2013 is related primarily to expenditures on product tooling and purchases of computer equipment. Investing activities in 2012 is related primarily to expenditures on tooling for our next generation mobile handheld computer which we began shipping into our distribution channel in June 2012.

Cash provided by financing activities was \$0.5 million in 2013 compared to \$0.6 million in 2012. Financing activities in 2013 consisted primarily of proceeds from the issuance of related party and other short term notes payable, partially offset by repayment of a short term note originally advanced on August 31, 2012 with final repayment completed in January 2013, and note redemptions by a related party convertible note holder and another note holder, and net repayments on our bank line of credit. Cash provided from financing activities in 2012 consisted primarily of proceeds from the issuance of related party subordinated convertible notes payable (see “NOTE 2 — Related Party Convertible Notes Payable” for more information), net proceeds from the advance of a short term loan (see “NOTE 3 — Related Party and Other Short-Term Notes Payable” for more information), and proceeds from stock option and warrant exercises. These were partially offset by net amounts paid on our bank lines of credit.

Our contractual obligations at December 31, 2013 are outlined in the table shown below:

	Payments Due by Period				
	Total	1 year	2 to 3 years	4 to 5 years	More than 5 years
Contractual Obligations					
Unconditional purchase	\$2,048,000	\$2,048,000	\$—	\$—	\$—

obligations with contract

manufacturers

Operating leases	3,738,000	378,000	802,000	868,000	1,690,000
Short term note payable	650,000	650,000	—	—	—
Capital leases	59,000	23,000	36,000	—	—
Total contractual obligations	\$6,495,000	\$3,099,000	\$838,000	\$868,000	\$1,690,000

Table of Contents

**Off-Balance Sheet Arrangements**

As of December 31, 2013, we had no off-balance sheet arrangements as defined in Item 303 of Regulation S-K.

**Recent Accounting Pronouncements**

See Note 1 of "Notes to Financial Statements" of this Annual Report for additional information regarding the status of recent accounting pronouncements.

Table of Contents

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to invested cash and our bank credit line facilities. Our cash is invested in short-term money market investments backed by U.S. Treasury notes and other investments that mature within one year and whose principal is not subject to market rate fluctuations. Accordingly, interest rate declines would adversely affect our interest income but would not affect the carrying value of our cash investments. Based on a sensitivity analysis of our cash investments during the quarter ended December 31, 2013, a decline of 1% in interest rates would not have had a material effect on our quarterly interest income. Our bank credit line facilities of up to \$2.5 million have variable interest rates based upon the greater of either 5% or the lender's prime rate plus 1%, for both the domestic line (up to \$1.5 million) and the international line (up to \$1.0 million). Accordingly, interest rate increases could increase our interest expense on our outstanding credit line balances. Based on a sensitivity analysis during the quarter ended December 31, 2013, an increase of 1% in the interest rate would have increased our quarterly borrowing costs by approximately \$3,000 (in cases where the applicable interest rate is greater than 5%).

**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 December 31, 2013, an adverse change of 10% in exchange rates would have resulted in an increase in our net loss for the fourth quarter 2013 of approximately \$22,000 if left unprotected. For the fourth quarter of 2013, 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 \$2,000. We will continue to monitor, assess, and mitigate through hedging activities, our risks related to foreign currency fluctuations.

**Item 8. Financial Statements and Supplementary Data**

The supplementary information required by this item is included in Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

—

32

Table of Contents

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

Socket Mobile, Inc.

We have audited the accompanying balance sheets of Socket Mobile, Inc. (the “Company”) as of December 31, 2013 and 2012, and the related statements of operations, stockholders’ equity and cash flows for the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements referred to above present fairly, in all material respects, the financial position of Socket Mobile, Inc. as of December 31, 2013 and 2012, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in the Note 1 to the financial statements, the Company has recurring net losses, an accumulated deficit of \$61,122,674 and a working capital deficit, all of which raises substantial doubt about its ability to continue as a going concern. Management’s plans concerning these matters are also described in Note 1 to the financial statements. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.



*/s/ Sadler, Gibb & Associates, LLC*

Salt Lake City, UT

March 28, 2014

—

33

Table of ContentsSOCKET MOBILE, INC.  
BALANCE SHEETS

	December 31,	
	2013	2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 606,255	\$ 390,513
Accounts receivable, net	1,427,590	1,509,094
Inventories	1,105,088	941,067
Prepaid expenses and other current assets	93,647	129,434
Total current assets	3,232,580	2,970,108
Property and equipment:		
Machinery and office equipment	1,918,187	1,865,137
Computer equipment	1,059,943	1,204,957
	2,978,130	3,070,094
Accumulated depreciation	(2,683,193 )	(2,727,323 )
Property and equipment, net	294,937	342,771
Intangible assets, net	30,000	90,000
Goodwill	4,427,000	4,427,000
Other assets	117,518	91,518
Total assets	\$ 8,102,035	\$ 7,921,397
 <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,454,594	\$ 3,697,209
Accrued expenses	69,554	74,554
Accrued payroll and related expenses	580,665	478,084
Bank line of credit	763,487	810,686
Deferred income on shipments to distributors	1,006,057	854,159
Related party and other short term notes payable	650,000	95,289
Related party convertible notes payable	777,625	750,000
Short term portion of deferred service revenue	172,474	214,537
Short term portion of capital leases and deferred rent	22,818	17,400
Total current liabilities	7,497,274	6,991,918
Long term portion of deferred service revenue	95,049	153,877
Long term portion of capital leases and deferred rent	265,002	227,022
Deferred income taxes	111,334	79,395
Total liabilities	7,968,659	7,452,212

Commitments and contingencies

Stockholders' equity:

Common stock, \$0.001 par value: Authorized – 20,000,000 shares,  
 Issued and outstanding – 4,867,063 shares at December 31, 2013

	4,867	4,861
and 4,861,063 shares at December 31, 2012		
Additional paid-in capital	61,251,183	60,966,505
Accumulated deficit	(61,122,674)	(60,502,181)
Total stockholders' equity	133,376	469,185
Total liabilities and stockholders' equity	\$8,102,035	\$7,921,397

See accompanying notes.

Table of ContentsSOCKET MOBILE, INC.  
STATEMENTS OF OPERATIONS

	Years Ended December 31,	
	2013	2012
Revenues	\$ 15,661,305	\$ 13,564,764
Cost of revenues	9,357,868	8,517,648
Gross profit	6,303,437	5,047,116
Operating expenses:		
Research and development	2,269,454	2,710,754
Sales and marketing	2,327,296	3,372,692
General and administrative	1,829,294	1,972,820
Total operating expenses	6,426,044	8,056,266
Operating loss	(122,607 )	(3,009,150 )
Interest expense and other, net	(465,947 )	(256,992 )
Net loss before deferred taxes	(588,554 )	(3,266,142 )
Deferred income tax expense	(31,939 )	(31,940 )
Net loss	\$(620,493 )	\$(3,298,082 )
Net loss per share:		
Basic and diluted	\$(0.13 )	\$(0.68 )
Weighted average shares outstanding:		
Basic and diluted	4,865,036	4,853,630

See accompanying notes.

Table of Contents**SOCKET MOBILE, INC.  
STATEMENTS OF STOCKHOLDERS' EQUITY**

	Common Stock		Additional	Accumulated	Total
	Shares	Amount	Paid-In Capital	Deficit	Stockholders' Equity
Balance at December 31, 2011	4,832,079	\$ 4,832	60,324,852	(57,204,099)	3,125,585
Exercise of warrants	16,666	17	29,982	—	29,999
Exercise of stock options	12,318	12	14,003	—	14,015
Stock-based compensation	—	—	597,668	—	597,668
Net loss	—	—	—	(3,298,082)	(3,298,082 )
Balance at December 31, 2012	4,861,063	4,861	60,966,505	(60,502,181)	469,185
Exercise of warrants	—	—	—	—	—
Exercise of stock options	6,000	6	6,474	—	6,480
Stock-based compensation	—	—	249,704	—	249,704
Common stock issued to settle litigation	—	—	28,500	—	28,500
Net loss	—	—	—	(620,493)	(620,493 )
Balance at December 31, 2013	4,867,063	\$ 4,867	\$ 61,251,183	\$(61,122,674)	\$ 133,376

See accompanying notes.

Table of ContentsSOCKET MOBILE, INC.  
STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2013	2012
Operating activities		
Net loss	\$(620,493 )	\$(3,298,082)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Stock-based compensation	249,704	597,668
Depreciation	221,337	264,512
Amortization of intangible assets	60,000	60,000
Deferred income tax expense	31,939	31,940
Fair value of common stock issued to settle litigation	28,500	—
Changes in operating assets and liabilities:		
Accounts receivable	81,505	1,282,455
Inventories	(164,021 )	519,985
Prepaid expenses and other current assets	9,787	77,986
Accounts payable and accrued expenses	(194,990 )	410,445
Accrued payroll and related expenses	102,580	(86,896 )
Deferred income on shipments to distributors	151,898	(717,385 )
Deferred service revenue	(100,891 )	(46,236 )
Change in deferred rent	49,245	(3,853 )
Net cash used in operating activities	(93,900 )	(907,461 )
Investing activities		
Purchase of equipment and tooling	(158,903 )	(234,856 )
Net cash used in investing activities	(158,903 )	(234,856 )
Financing activities		
Payments on capital leases	(20,447 )	(14,581 )
Proceeds from borrowings under bank line of credit agreement	8,017,095	6,438,779
Repayments of borrowings under bank line of credit agreement	(8,064,294)	(6,737,693)
Stock options exercised	6,480	14,015
Warrants exercised	—	29,999
Proceeds from issuance of related party subordinated convertible notes payable	—	750,000
Proceeds from issuance of short term note payable	700,000	400,000
Repayment of short term notes payable	(145,289 )	(304,711 )
Repayment of related party subordinated convertible note payable	(25,000 )	—
Net cash provided by financing activities	468,545	575,808
Net increase (decrease) in cash and cash equivalents	215,742	(566,509 )
Cash and cash equivalents at beginning of year	390,513	957,022
Cash and cash equivalents at end of year	\$606,255	\$390,513
Supplemental cash flow information		
Cash paid for interest	\$387,092	\$224,775
Non-cash investing and financing activities:		
Conversion of accrued note payable interest to note principal	\$52,625	\$—
Addition of equipment under capital lease	\$14,600	\$—

See accompanying notes.

—  
37

Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS**

**NOTE 1 — Summary of Significant Accounting Policies**

Organization and Business

Socket Mobile, Inc. (the “Company”), produces barcode scanning and mobile handheld computer products serving the business mobility market and designed for the mobile worker. The Company offers a family of cordless barcode scanning products that connect over Bluetooth with smartphones, tablets and mobile computers. The Company also offers wearable cordless ring scanners for hands free barcode scanning. The Company offers a family of general purpose handheld computer products running the Windows Embedded Handheld System 6.5 operating system and a wide range of accessories including plug-in two dimensional (2D) and linear (1D) bar code scanners, cradles, Radio Frequency Identification (RFID) readers, and magnetic stripe readers. The Company also offers customized versions of its handheld computers as OEM products to third-party companies. The Company’s cordless hand scanners work with many third-party mobile handheld devices, and the Company’s plug-in data collection products work with the Company’s handheld computers. For a complete description of the Company’s products see “Products” in “Item 1. Business.”

The Company works closely with software application developers offering or developing software applications for use with the Company’s family of barcode scanners and mobile handheld computers. The Company offers software developers kits to enable developers to easily integrate the Company’s barcode scanning products into their applications, and to enable greater hardware control in applications using the Company’s mobile handheld computers. The Company’s family of barcode scanners are designed to work with a wide range of smartphones, tablets, and computers running operating systems from Apple (iOS), Google (Android), and Microsoft (Windows/Windows Mobile). The primary segments being addressed by our registered developers are retail point of sale, healthcare, and commercial services. Healthcare and hospitality are two of the primary areas of focus for software application developers who have developed applications for use on the Company’s handheld computers. Other vertical markets benefiting from mobile solutions include inspections, automotive, government and education. These mobile application solutions are designed to improve the productivity of business enterprises and service providers.

The Company subcontracts the manufacturing of substantially all of its products to independent third-party contract manufacturers who are located in the U.S., Mexico, China and Taiwan and who have the equipment, know-how and capacity to manufacture products to the Company’s specifications. The Company markets its products through a worldwide network of distributors and resellers, as well as through original equipment manufacturers and value added



resellers. The geographic regions served by the Company include the Americas, Europe, the Middle East, Africa and Asia Pacific. The Company's total employee headcount on December 31, 2013 was 48 people.

The Company was founded in March 1992 as Socket Communications, Inc. and reincorporated in Delaware in 1995 prior to the Company's initial public offering in June 1995. The Company began doing business as Socket Mobile, Inc. in January 2007 to better reflect its market focus on the mobile business market, and changed its legal name to Socket Mobile, Inc. in April 2008. The Company's common stock trades on the OTCQB Marketplace under the symbol "SCKT." The Company's principal executive offices are located at 39700 Eureka Drive, Newark, CA 94560.

—

38

Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

*Liquidity and Going Concern*

During the years ended December 31, 2013 and 2012, the Company incurred net losses of \$620,493 and \$3,298,082, respectively. As of December 31, 2013, the Company has an accumulated deficit of \$61,122,674. The Company's cash balance at December 31, 2013 was \$606,255. At December 31, 2013, the Company had additional unused borrowing capacity of approximately \$103,000 on its bank lines of credit (approximately \$93,000 and \$10,000, respectively, on the domestic and international credit lines). The Company's balance sheet at December 31, 2013 has a current ratio (current assets divided by current liabilities) of 0.4 to 1.0, and a working capital deficit of \$4,264,694 (current assets less current liabilities). These circumstances raise substantial doubt about the Company's ability to continue as a going concern.

In the last three years the Company has taken actions to reduce its expenses and to align its cost structure with economic conditions. The Company has the ability to further reduce expenses if necessary. Steps taken by the Company to reduce operating losses and achieve profitability include reduction of headcount to manage payroll costs, the introduction of new products, and continued close support of the Company's distributors and application development partners as they establish their mobile applications in key vertical markets. The Company believes it will be able to further improve its liquidity and secure additional sources of financing by managing its working capital balances, use of its bank lines of credit, and raising additional capital as needed including development funding from development partners and the issuance of additional equity securities. However, there can be no assurance that additional capital will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. The Company's bank lines of credit may be terminated by the bank or by the Company at any time. If the Company cannot maintain profitability, it will not be able to support its operations from positive cash flows, and would use its existing cash to support operating losses. If the Company is unable to secure the necessary capital for its business, it may need to suspend some or all of its current operations.

If the Company can maintain revenue growth and attain ongoing profitability, it anticipates requirements for cash will include funding of higher receivable and inventory balances, and increased expenses, including an increase of costs relating to new employees to support our growth and increases in salaries, benefits, and related support costs for employees.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. These financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the

Company's inability to continue as a going concern.

*Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements as well as 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.

—

39

Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

*Cash Equivalents*

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. As of December 31, 2013 and 2012, all of the Company's cash and cash equivalents consisted of demand and money market deposits held in accounts within a single bank.

*Fair Value of Financial Instruments*

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.

*Derivative Financial Instruments*

The Company's primary objective for holding derivative financial instruments is to manage foreign currency risks. The Company's derivative financial instruments are recorded at fair value and are included in other current assets, other assets, other accrued liabilities or long-term debt depending on the contractual maturity and whether the Company has a gain or loss. The Company's accounting policies for these instruments are based on whether they meet the Company's criteria for designation as hedging transactions, either as cash flow or fair value hedges. A hedge of the exposure to variability in the cash flows of an asset or a liability, or of a forecasted transaction, is referred to as a cash flow hedge. A hedge of the exposure to changes in fair value of an asset or a liability, or of an unrecognized firm commitment, is referred to as a fair value hedge. The criteria for designating a derivative as a hedge include the instrument's effectiveness in risk reduction and, in most cases, a one-to-one matching of the derivative instrument to its underlying transaction. Gains and losses on derivatives that are not designated as hedges for accounting purposes are recognized currently in earnings. The Company regularly enters into forward foreign currency contracts to reduce exposures related to rate changes in certain foreign currencies.

The Company's forward foreign currency contracts are recorded at fair value at December 31, 2013. At December 31, 2013, these derivative instruments were not designated as hedges, and accordingly, changes in the fair value of the forward foreign currency contracts were recorded in earnings. At December 31, 2013 contracts with a notional amount of \$171,750 to hedge Euros had a fair value of an immaterial amount based on quotations from financial institutions, and had maturity dates in January 2014. At December 31, 2012 contracts with a notional amount of \$264,400 to hedge Euros and \$185,185 to hedge Yen had fair values of an immaterial amount for each currency based on quotations from financial institutions, and had maturity dates in January 2013.

*Foreign Currency*

The functional currency for the Company is the U.S. dollar. Assets and liabilities denominated in foreign currencies are translated using the exchange rates on the balance sheet dates. Revenues and expenses are translated using the average exchange rates prevailing during the year. Any translation adjustments resulting from this process are shown separately as a component of accumulated other comprehensive income (loss) within shareholders' equity in the balance sheets. Foreign currency transaction gains and losses are reported in other income and expense, net, in the statements of income.

—  
40

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)***Accounts Receivable Allowances*

The Company estimates the amount of uncollectible accounts receivable at the end of each reporting period based on the aging of the receivable balance, current and historical customer trends, and communications with its customers. Amounts are written off only after considerable collection efforts have been made and the amounts are determined to be uncollectible. The following describes activity in the allowance for doubtful accounts for the years ended December 31, 2013 and 2012:

Year	Balance at Beginning of Year	Charged to Costs and Expenses	Amounts Written Off	Balance at End of Year
2013	\$ 89,058	\$ —	\$ —	\$ 89,058
2012	\$ 89,058	\$ —	\$ —	\$ 89,058

*Inventories*

Inventories consist principally of raw materials and sub-assemblies stated at the lower of standard cost, which approximates actual costs (first-in, first-out method), or market. Market is defined as replacement cost, but not in excess of estimated net realizable value or less than estimated net realizable value less a normal margin. At the end of each reporting period, the Company compares its inventory on hand to its forecasted requirements for the next nine month period and the Company writes-off the cost of any inventory that is surplus, less any amounts that the Company believes it can recover from the disposal of goods that it specifically believes will be saleable past a nine month horizon. The Company's sales forecasts are based upon historical trends, communications from customers, and marketing data regarding market trends and dynamics. Changes in the amounts recorded for surplus or obsolete inventory are included in cost of revenue. Inventory components at year-end, net of write-downs, are presented in the following table:

	December 31,	
	2013	2012
Raw materials and sub-assemblies	\$1,045,356	\$921,677
Finished goods	59,732	19,390
	\$1,105,088	\$941,067

### *Property and Equipment*

Property and equipment are stated at cost. Depreciation and amortization are computed using the straight-line method, over the estimated useful lives of the assets ranging from one to five years. Assets under capital leases are amortized in a manner consistent with the Company's normal depreciation policy for owned assets, or the remaining lease term as applicable. Depreciation expense in the years ended December 31, 2013 and 2012, was \$221,337 and \$264,512, respectively.

### Goodwill

Goodwill is tested for impairment annually as of September 30th or more frequently when events or circumstances indicate that the carrying value of the Company's single reporting unit more likely than not exceeds its fair value. The Company performed its annual goodwill impairment analysis as of September 30, 2013. The Company used the two-step test as required to assess goodwill for impairment. The first step of the goodwill impairment test consisted of comparing the carrying value of the reporting unit to its fair value. Management estimated the fair value of the Company's reporting unit using various methods and compared the fair value to the carrying amount (net book value) to ascertain if potential goodwill impairment existed. The Company utilized methods that focused on its ability to produce income ("Income Approach") and the Company's market capitalization ("Market Capitalization Approach"). Key assumptions utilized in the determination of fair value in step one of the test included the following: the Company's market capitalization; revenue and expense forecasts used in the evaluation were based on trends of historical performance and management's estimate of future performance; cash flows utilized in the discounted cash flow analysis were estimated using a weighted average cost of capital determined to be appropriate for the Company. No impairment of goodwill was recorded in the two years ended December 31, 2013.

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)***Deferred Rent*

The Company operates its headquarters under a non-cancelable operating lease. The Company recognizes rent expense under its lease on a straight line basis measured over the term of the lease. The excess of accumulated rental expense measured on a straight lined basis over actual accumulated rent paid is capitalized as a liability on the Company's balance sheet in its short and long term components. Deferred rent at December 31, 2013 and 2012 was \$228,773 and \$179,527, respectively, and was classified as long term at each reporting date.

*Concentration of Credit Risk*

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. The Company invests its cash in demand and money market deposit accounts in banks. To the extent of the amounts recorded on the balance sheet, cash is concentrated at the Company's bank to the extent needed to comply with the minimum liquidity ratio of the bank line agreement. To date, the Company has not experienced losses on these investments. The Company's trade accounts receivables are primarily with distributors and original equipment manufacturers (OEMs). The Company performs ongoing credit evaluations of its customers' financial conditions 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 December 31, 2013 and 2012, were as follows:

	December 31, 2013		December 31, 2012	
Company A	43	%	16	%
Company B	28	%	28	%
Company C	14	%	12	%
Company D	*		12	%
Company E	*		11	%

*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 an interruption of supply or increased demand in the industry. If the Company were unable to procure certain of such materials, it would be required to reduce its operations, which could have a material adverse effect upon its results. At December 31, 2013 and 2012, 28% and 32%, respectively, of the Company's accounts payable balances were concentrated in a single supplier. For the years ended December 31, 2013 and 2012, this and another supplier accounted for 49% and 64%, respectively, of the inventory purchases in each of these years.

—  
42

Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

*Revenue Recognition and Deferred Income*

Revenue on sales to customers other than distributors is recognized upon shipment provided that persuasive evidence of a sales arrangement exists, the price is fixed or determinable, title has transferred, collection of resulting receivables is reasonably assured, there are no customer acceptance requirements, and there are no remaining significant obligations. Revenue on sales to distributors where a right of return exists is recognized upon “sell-through,” when products are shipped from the distributor to the distributor’s customer. Revenue related to those products in the Company’s distribution channel at the end of each reporting period which has not sold-through is deferred. The amount of deferred revenue net of related cost of revenue is classified as deferred income on shipments to distributors on the Company’s balance sheet. At December 31, 2013 and 2012, deferred income on shipments to distributors represented deferred revenues totaling \$2,144,546 and \$1,804,367, respectively, net of related costs of those revenues of \$1,138,489 and \$950,208, respectively.

The Company defers revenue and income on advance payments from customers when performance obligations have yet to be completed and/or services performed. Such deferred revenue does not include amounts related to products delivered to distributors which have not sold-through to the distributors’ end customers as described above.

The Company also earns revenue from its SocketCare services program which provides for extended warranty and accidental breakage coverage for selected products. Service purchased at the time of product purchase provides for coverage in two-year and three-year terms. We additionally offer comprehensive coverage and program term extensions. Revenues from the SocketCare services program are recognized ratably over the life of the extended warranty contract. The amount of unrecognized warranty service revenue is classified as deferred service revenue and presented on the Company’s balance sheet in its short and long term components. The Company also earns revenue from services performed in connection with consulting arrangements. For those contracts that include contract milestones or acceptance criteria the Company recognizes revenue as such milestones are achieved or as such acceptance occurs. In some instances the acceptance criteria in the contract requires acceptance after all services are complete and all other elements have been delivered. Revenue recognition is deferred until those requirements are met. Revenues related to these services in the years presented were not material.

*Warranty*

The Company’s products typically carry a one year warranty. The Company reserves for estimated product warranty costs at the time revenue is recognized based upon the Company’s historical warranty experience, and additionally for any known product warranty issues. If actual costs differ from initial estimates, the Company records the difference in

the period they are identified. Actual claims are charged against the warranty reserve

*Research and Development*

Research and development expenditures are charged to operations as incurred. The major components of research and development costs include salaries and employee benefits, stock-based compensation expense, third party development costs including consultants and outside services, and allocations of overhead and occupancy costs.

—

43

Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

The accounting for the costs of computer software to be sold, leased or otherwise marketed, requires the capitalization of certain software development costs subsequent to the establishment of technological feasibility. Based on the Company's product development process, technological feasibility is established upon the completion of a working model. Costs incurred by the Company between the completion of the working model and the point at which the product is ready for general release have been insignificant. Accordingly, the Company has charged all such costs to research and development expenses in the accompanying statements of operations.

*Advertising Costs*

Advertising costs are charged to sales and marketing as incurred. The Company incurred \$217,881 and \$332,594, in advertising costs during 2013 and 2012, respectively.

*Income Taxes*

The Company uses the asset and liability method to account for income taxes. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company records a valuation allowance against deferred tax assets when it is more likely than not that such assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company recognizes the tax benefit from uncertain tax positions if it is more likely than not that the tax positions will be sustained on examination by the tax authorities, based on the technical merits of the position. The tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

*Shipping and handling costs*

Shipping and handling costs are included in the cost of revenues in the statement of operations.



Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)***Net Loss Per Share*

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

	Years Ended December	
	31,	
	2013	2012
Numerator:		
Net loss	\$(620,493 )	\$(3,298,082 )
Denominator:		
Weighted average common shares outstanding used in computing net loss per share:		
Basic and diluted	4,865,036	4,853,630
Net loss per share applicable to common stockholders:		
Basic and diluted	\$(0.13 )	\$(0.68 )

For the 2013 and 2012 periods presented, the diluted net loss per share is equivalent to the basic net loss per share because the Company experienced losses in these years and thus no potential common shares underlying stock options or warrants, or shares underlying conversion of convertible notes, have been included in the net loss per share calculation as their effect is anti-dilutive. Options and warrants to purchase, and shares issuable for convertible notes and related accrued interest, totaled 3,342,915 and 2,790,800 shares of common stock in 2013 and 2012, respectively, have been omitted from the loss per share calculation.

*Stock-Based Compensation*

The Company accounts for stock-based compensation of stock options granted to employees and directors and of employee stock purchase plan shares by estimating the fair value of stock-based awards using the binomial lattice model. The fair value is amortized as compensation expense over the requisite service period of the award on a straight-line basis. The binomial lattice model incorporates calculations for expected volatility, risk-free interest rates, employee exercise patterns and post-vesting employment termination behavior, and these factors affect the estimate of the fair value of the Company's stock option grants.

The weighted average assumptions and grant date fair values for options granted are as follows:

	Years Ended	
	December 31,	
	2013	2012
Risk-free interest rate (%)	2.01 %	1.77 %
Dividend yield	—	—
Volatility factor	0.9	0.7
Expected option life (years)	4.7	4.9
Weighted average grant date fair value	\$0.77	\$0.98

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)**

Stock-based compensation expenses included in the Company's statement of operations is as follows:

Income Statement Classification	Years Ended December 31,	
	2013	2012
Cost of revenues	\$26,196	\$50,660
Research and development	72,104	136,618
Sales and marketing	43,970	128,759
General and administrative	107,434	281,631
	\$249,704	\$597,668

At December 31, 2013, the fair value of unamortized stock-based compensation expense was \$273,636, and will be amortized over a weighted average period of 2.19 years.

*Segment Information*

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief executive officer in deciding how to allocate resources and in assessing performance.

The Company operates in one segment—mobile systems solutions for businesses. Mobile systems solutions typically consist of a handheld computer or other mobile device such as a smartphone or tablet, some with data collection peripherals, and third-party vertical applications software. The Company markets its products in the United States and foreign countries through its sales personnel and distributors.

Revenues for the geographic areas for the years ended December 31, 2013 and 2012 are as

follows:



Revenues: (in thousands)	Years Ended	
	December 31,	
	2013	2012
United States	\$10,918	\$8,078
Europe	2,728	3,554
Asia and rest of world	2,015	1,933
	\$15,661	\$13,565

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.

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)**

Information regarding product families for the years ended December 31, 2013 and 2012 is as follows:

Revenues: (in thousands)	Years Ended December 31,	
	2013	2012
Cordless barcode scanning and related product and service	\$9,747	\$5,953
Mobile handheld computer and related product and service	5,287	7,187
Other	627	425
	\$15,661	\$13,565

**Major Customers**

Customers who accounted for at least 10% of total revenues for the years ended December 31, 2013 and 2012 were as follows:

	Years Ended December 31,	
	2013	2012
Scansource, Inc.	20%	21%
Ingram Micro Inc.	20%	17%
BlueStar, Inc.	15%	10%

*Recently Issued Financial Accounting Standards*

In July 2013, the Financial Accounting Standards Board ("FASB"), issued authoritative guidance which concludes that, under certain circumstances, unrecognized tax benefits should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The Company adopted this guidance early, as permitted, for the fiscal year ended December 31, 2013. The adoption of this guidance did not have a material effect on the Company's financial statements.

In February 2013, the FASB issued amendments to disclosure requirements for presentation of comprehensive income. The standard requires presentation (either in a single note or parenthetically on the face of the financial statements) of the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, a cross reference to the related footnote for additional information is required. The amendments are effective prospectively for reporting periods beginning after December 15, 2012. The adoption of this guidance did not have a material effect on the Company's financial statements.

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Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

In July 2012, the FASB issued authoritative guidance related to testing indefinite-lived intangible assets for impairment. This guidance simplifies how entities test indefinite-lived intangible assets for impairment and permits an entity to first assess qualitative factors to determine whether it is more likely than not that the indefinite-lived intangible asset is impaired. This guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The adoption of this guidance did not have a material effect on the Company's financial statements.

**NOTE 2 — Related Party Convertible Notes Payable**

On September 4, 2013, the Company replaced \$350,000 of convertible notes plus accrued interest (total of \$380,696) originally issued to officers and directors of the Company on August 1, 2012 and maturing on August 1, 2014, with four year convertible notes expiring September 4, 2017. The replacement notes have an interest rate of 8% per annum that compounds quarterly, and contain a holder call provision that becomes effective on September 4, 2014. The replacement notes are convertible into common stock at the option of the holder at \$2.44 per share as long as warrants issued on November 19, 2010 are outstanding (expire May 20, 2016), or at \$1.25 per share. The original issuance of convertible notes on August 1, 2012 was in the amount of \$400,000. The notes are being used for working capital purposes. During the nine months ended September 30, 2013, \$25,000 of the original convertible notes were repaid, \$350,000 of the notes were reissued as discussed previously, and \$25,000 of the original notes remain outstanding. The remaining original notes accrue interest at 8% per annum, contain a holder call provision, and mature on August 1, 2014. Accrued interest is payable upon redemption. The remaining original notes are convertible into common stock at the option of the holder at \$2.44 per share as long as warrants issued on November 19, 2010 are outstanding (expire May 20, 2016), or at \$2.00 per share. The convertible notes are secured by all of the assets of the Company and are subordinated to amounts outstanding under the Company's working capital bank line of credit with Silicon Valley Bank.

On September 4, 2013, the Company also replaced \$350,000 of convertible notes plus accrued interest (total of \$371,929) issued to the Company's Chairman at various dates in the fourth quarter of 2012 and maturing on August 1, 2014, with four year convertible notes expiring September 4, 2017. The replacement notes are convertible into common stock at the option of the holder at \$2.44 per share as long as warrants previously issued on November 19, 2010 are outstanding (expire May 20, 2016), or at the closing market price on the date of note issue of \$1.25 per share, have eliminated the holder call provision contained in the original notes, and have an interest rate that compounds quarterly of 18% per annum during the period in which the November 19, 2010 warrants are outstanding, or 12% per annum. Previously on November 5, 2012, the Company's Board of Directors approved the issue of up to \$350,000 in convertible subordinated notes to its Chairman to be used for working capital purposes. At various dates beginning

November 7, 2012 through December 12, 2012 the Company issued in total \$350,000 of such notes to its Chairman. The original notes were identical to the notes issued on August 1, 2012 as described in the preceding paragraph, with the exception of the conversion price of which the weighted average fair market value conversion price was \$1.04 per share as long as warrants previously issued on November 19, 2010 were no longer outstanding. The notes are secured by all of the assets of the Company and are subordinated to amounts outstanding under the Company's working capital bank line of credit with Silicon Valley Bank.

—

48

Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

The Company determined per ASC 470-50-40-10a, that the fair value of the embedded conversion option in the reissued convertible notes as a result of the change in conversion price and term, increased by more than 10% from the original notes. Therefore, debt extinguishment accounting rules apply. Accordingly, the reissued convertible notes payable were initially recorded at fair value; however, as there was no difference between the reissued amount of the notes and the net carrying amount of the original notes, no gain or loss was recorded. Accrued interest expense at December 31, 2013 related to all convertible subordinated notes outstanding was \$34,837.

**NOTE 3 — Related Party and Other Short-Term Notes Payable**

On January 31, 2013, the Company's Board of Directors approved a subordinated line of credit of up to \$1,000,000 including up to \$550,000 in advances by the Company's Chairman. The funds raised are being used for working capital purposes. On December 31, 2013, a total of \$650,000 in funds were outstanding under this line, of which \$450,000 and \$50,000 respectively were from the Company's Chairman and Chief Executive Officer. The line had an expiration date of December 1, 2013, which in November 2013 was extended to June 1, 2014. Interest accrues at the rate of 1% per week and is paid weekly. Balances outstanding under the line of credit are to be repaid in full on or before the maturity date. Balances under the line of credit are secured by all of the assets of the Company and are subordinated to amounts outstanding under the Company's credit facility with its bank. Interest expense in the year ended December 31, 2013 related to the line of credit was \$263,772.

On August 31, 2012, the Company issued a promissory note to a lender for \$400,000. The promissory note matured on January 31, 2013 and had an implied monthly compounded interest rate of 9.7%. The Company was required to pay a total of \$528,000 principal and interest on the promissory note in weekly installments of approximately \$25,000. The note was secured by substantially all the Company's assets including intangible assets. This promissory note was subordinated to the bank financing arrangement as described in Note 4. During the first quarter 2013, the Company completed the repayment of the remaining principle and interest in the amounts of \$95,289, and \$7,711, respectively.

**NOTE 4 — Bank Financing Arrangements**

The Company in the two years presented had a credit facility agreement with Silicon Valley Bank (the "Bank"). The credit facility allowed the Company to borrow up to \$2,500,000 based on the level of qualified domestic and

international receivables, up to a maximum of \$1,500,000 and \$1,000,000, respectively. Advances against the domestic line were calculated at 80% of qualified receivables except for receivables from distributors which are calculated at 60%. Advances against the international line were calculated at 90% against qualified hedged receivables and 70% against qualified non-hedged receivables and receivables from distributors. Borrowings under the lines bore an annual interest rate equal to the greater of (i) the Bank's prime rate plus 1%, or (ii) 5%. The rate in effect has been 5% to date. There was also a collateral handling fee of 0.25% per month of the financed receivable balance outstanding. The applicable interest and fees were calculated based on the full amount of the accounts receivable provided as collateral for the actual amounts borrowed. The effective rate (interest plus all applicable fees) on actual cash advances in 2013 was 13.6% per annum.

—

49

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)**

The credit facility agreement was to expire on October 12, 2013 unless renewed. On October 12, 2013, the Company and the Bank agreed to extend the agreement for an additional three month period ending January 10, 2014, and subsequently further extended the agreement up to February 28, 2014 to facilitate the Company's transition to a new bank and credit line (see the additional discussion in the paragraph that follows). The agreement could be terminated by the Company or by the Bank at any time. Upon such termination, the Bank would no longer make advances under the credit agreement and outstanding advances would be repaid as receivables are collected. All advances were at the Bank's discretion and the Bank was not obligated to make advances. In addition, the Company was to maintain a minimum liquidity ratio at all times based on quick assets (unrestricted cash equivalents at the Bank plus net eligible accounts receivable) to outstanding obligations to the Bank of not less than 2.0 to 1.0. The outstanding amounts borrowed under the domestic and international lines at December 31, 2013 were \$655,130 and \$108,357, respectively, and the full amounts of accounts receivable provided as collateral were \$1,078,053, and \$153,372, respectively. The outstanding amounts borrowed under the domestic and international lines at December 31, 2012 were \$479,647 and \$331,039, respectively, and the full amounts of accounts receivable provided as collateral were \$777,987, and \$464,731, respectively. The total interest expense on the amounts drawn during the year ended December 31, 2013 and 2012, was \$117,551 and \$98,861, respectively. Accrued interest related to the amounts outstanding at December 31, 2013 and 2012 was \$7,019 and \$7,237, respectively.

*New Bank Line of Credit*

On January 8, 2014, the Company accepted the terms of a credit facility agreement with Bridge Bank (the "New Bank"). The Silicon Valley Bank agreement was extended to February 28, 2014 to facilitate the transfer of the credit facility to the New Bank. The credit facility was activated and transfer completed on March 7, 2014. The revolving credit line agreement is for a two year period ending February 27, 2016. Under the terms of the credit facility agreement with the New Bank, the Company may borrow up to \$2.5 million, of which up to \$1.5 million is based on qualified receivables from domestic customers and up to \$1.0 million is based on qualified receivables from international customers. The Company's total borrowings under the line may not exceed 50% of the sum of cash plus qualified receivables. Advances against the domestic and international lines are calculated at 70% of qualified receivables. Borrowings under the lines bear an annual interest rate equal to the New Bank's prime rate plus 1.5%. The rate in effect at March 7, 2014 is 4.75% per annum. There is also a collateral handling fee of 0.2% per month of the financed receivable balance outstanding. The applicable interest and fees are calculated based on the actual amounts borrowed. As of March 7, 2014, the effective rate (interest plus all applicable fees) on actual cash advanced is 4.95% per annum. The borrowings under the credit facility are secured by a first priority security interest in the assets of the Company. All advances are at the New Bank's discretion and the New Bank is not obligated to make advances. The agreement may be terminated by the Company or by the New Bank at any time.





Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)****NOTE 5 — Intangible Assets**

Intangible assets consist of a patent purchased in 2004 for \$600,000 covering the design and functioning of plug-in bar code scanners, bar code imagers, and radio frequency identification products, which is being amortized on a straight line basis over its estimated life of ten years. Intangible assets of \$570,750 remaining from a prior acquisition in 2000 consisting of developed software and technology with estimated lives at the time of acquisition of 8.5 years was fully amortized in the quarter ended June 30, 2009.

Amortization of all intangible assets was \$60,000 in each of the years ended December 31, 2013 and 2012, and are included in research and development expense. Intangible assets as of December 31, 2013 consisted of the following:

	Gross	Accumulated	
	Assets	Amortization	Net
Patent	\$600,000	\$570,000	\$30,000
Project management tools	570,750	570,750	—
Total intangible assets	\$1,170,750	\$1,140,750	\$30,000

The Company will complete the amortization of the above intangible assets in the first half of 2014.

Intangible assets as of December 31, 2012 consisted of the following:

	Gross	Accumulated	
	Assets	Amortization	Net
Patent	\$600,000	\$510,000	\$90,000
Project management tools	570,750	570,750	—
Total intangible assets	\$1,170,750	\$1,080,750	\$90,000

**NOTE 6 — Commitments and Contingencies**

*Operating Lease*

The Company operates its headquarters under a non-cancelable operating lease which provides for the lease by the Company of approximately 37,100 square feet of space in Newark, California. On December 28, 2012, the Company amended its commercial building lease agreement to extend the term of the lease to June 30, 2022. The base rent under the facilities lease was \$29,705 per month for the period from July 1, 2012 through June 30, 2013. The base rent increased 4% to \$30,893 beginning July 1, 2013 through June 30, 2014. The base rent increases annually thereafter at a rate of four percent per year for the remaining term of the lease ending June 30, 2022.

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)**

Future minimum lease payments under all operating leases are as shown below:

Annual minimum payments:	Amount
2014	\$378,130
2015	393,255
2016	408,986
2017	425,345
2018 to 2022	2,132,136
Total minimum payments	\$3,737,852

Rental expense under all operating leases for the years ended December 31, 2013 and 2012 was \$427,827 and \$373,143, respectively. The amount of deferred rent at December 31, 2013 and December 31, 2012 was \$288,773 and \$179,527, respectively.

*Capital Lease Obligations*

The Company leases certain of its equipment under capital leases. The leases are collateralized by the underlying assets. At December 31, 2013 and December 31, 2012, property and equipment with a cost of \$87,945 and \$73,275, respectively, were subject to such financing arrangements. Related accumulated amortization at December 31, 2013 and December 31, 2012, amounted to \$20,518 and \$8,380, respectively.

Future minimum payments under capital lease and equipment financing arrangements as of December 31, 2013, are as follows:

Annual minimum payments:	Amount
2014	26,467
2015	26,467
2016	11,916

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Total minimum payments	64,850
Less amount representing interest	(5,803 )
Present value of net minimum payments	\$59,047
Short term portion of capital leases	(22,818)
Long term portion of capital leases	\$36,229

*Purchase Commitments*

As of December 31, 2013, the Company has non-cancelable purchase commitments for inventory to be used in the ordinary course of business of approximately \$2,048,000.

*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.

Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

On October 9, 2013, Hudson Bay Master Fund Ltd. filed a complaint in the United States District Court for the Northern District of Illinois, Eastern Division, alleging that the Company had triggered anti-dilution provisions of its warrant and was entitled to adjustment of the exercise price and the number of shares. The warrant was issued on November 19, 2010 for 500,000 shares at an exercise price of \$2.44 per share. On December 28, 2013, the Company agreed to a settlement with Hudson Bay Master Fund Ltd. and the case was dismissed without judgment as to the merits of Hudson Bay Master Fund's allegations. In the settlement, the Company agreed to amend the warrant to reset the conversion price to \$1.25 per share under the anti-dilution provisions of the warrant, and increase the number of common shares issuable upon exercise to 976,000 shares, which retains the total amount of proceeds under the terms of the original warrant. The amended warrant is a continuation of the original warrant under the anti-dilution terms and does not constitute a change in the underlying warrant. The Company also agreed to issue 37,500 shares of common stock to the warrant holder, valued at the reported closing price on December 31, 2013 of \$0.76 per share, resulting in an expense of \$28,500 in the fourth quarter. The shares of common stock were subsequently issued in January 2014.

**NOTE 7 — Stock Option/Stock Issuance Plan**

The Company has one Stock Option Plan in effect in the two years presented: the 2004 Equity Incentive Plan (the "2004 Plan"). The 2004 Plan provides for the grant of incentive stock options, nonstatutory stock options, restricted stock, stock appreciation rights, and performance awards, to employees, directors, and consultants of the Company. Upon ratification of the 2004 Plan by the shareholders in June 2004, shares in the 1995 Plan that had been reserved but not issued, as well as any shares issued that would otherwise return to the 1995 Plan as a result of termination of options or repurchase of shares, were added to the shares reserved for issuance under the 2004 Plan. The Company grants incentive stock options and non-statutory stock options at an exercise price per share equal to the fair market value per share of common stock on the date of grant. The vesting and exercise provisions are determined by the Board of Directors, with a maximum term of ten years. The 2004 Plan expires on April 23, 2024.



Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)**

Information with respect to the 2004 Plan is summarized as follows:

	Options Available For Grant	Outstanding Options Number of Shares	Weighted Average Price Per Share
Balance at December 31, 2011	90,571	1,410,090	\$ 2.70
Increase in shares authorized	193,283	—	
Granted	(409,900 )	409,900	\$ 1.73
Exercised	—	(7,318 )	\$ 1.92
Canceled	188,484	(188,484 )	\$ 2.65
Balance at December 31, 2012	62,438	1,624,188	\$ 2.47
Increase in shares authorized	194,442	—	
Granted	(241,900 )	241,900	\$ 1.16
Exercised	—	(6,000 )	\$ 1.08
Canceled	200,918	(200,918 )	\$ 2.41
Balance at December 31, 2013	215,898	1,659,170	\$ 2.29

The 2004 Plan provides for an annual increase in the number of shares authorized under the plan to be added on the first day of each fiscal year equal to the lesser of 200,000 shares, four percent of the outstanding shares on that date, or a lesser amount as determined by the Board of Directors. On January 1, 2014, 2013, and 2012, a total of 194,682, 194,442, and 193,283 additional shares, respectively, became available for grant from the 2004 Plan. As of March 21, 2014, 204,100 options at a weighted average grant price of \$0.95 per share have been granted from the 2004 Plan subsequent to December 31, 2013.

The outstanding and exercisable options at December 31, 2013 presented by price range are as follows:

Range of Exercise	Options Outstanding		Options Exercisable	
	Number of Options	Weighted Average	Weighted Average	Number of Options



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Prices	Outstanding	Remaining Life (Years)	Exercise Price	Exercisable	Exercise Price
\$1.03 - \$1.20	335,922	9.08	\$ 1.07	191,392	\$ 1.09
\$1.50 - \$1.82	186,972	7.75	\$ 1.74	117,562	\$ 1.77
\$1.95 - \$2.36	411,917	4.08	\$ 2.14	333,358	\$ 2.11
\$2.49 - \$2.74	67,601	6.58	\$ 2.73	58,641	\$ 2.74
\$3.04 - \$3.45	653,268	6.50	\$ 3.08	653,268	\$ 3.08
\$6.90 - \$7.20	1,050	4.50	\$ 6.94	1,050	\$ 6.94
\$10.00 - \$11.70	1,790	2.67	\$ 10.80	1,790	\$ 10.80
\$15.00	650	1.00	\$ 15.05	650	\$ 15.05
\$1.03 - \$15.00	1,659,170	6.58	\$ 2.29	1,357,711	\$ 2.45

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54

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)****NOTE 8 — Warrants**

The Company has the following outstanding warrants to purchase common stock at December 31, 2013:

Reason	Number of Shares	Price Per Share	Issue Date	Expiration Date
Common stock financing	57,776	\$1.80	May 2009	May 2014
Senior convertible note financing (fully converted in 2011) (a)	976,000	\$1.25	Nov 2010	May 2016
	1,033,776			

The Company had the following outstanding warrants to purchase common stock at December 31, 2012:

Reason	Number of Shares	Price Per Share	Issue Date	Expiration Date
Common stock financing	57,776	\$1.80	May 2009	May 2014
Senior convertible note financing (fully converted in 2011) (a)	550,000	\$2.44	Nov 2010	May 2016
	607,776			

(a) In conjunction with a settlement agreement, the warrant was amended on December 31, 2013 to reset the conversion price under the anti-dilution terms of the warrant from the original \$2.44 per share to \$1.25 per share, and to increase the common shares issuable upon conversion from 550,000 shares to 976,000 shares (see “*Legal*

*Matters*” within “NOTE 6 — Commitments and Contingencies” for more information).

#### **NOTE 9 — Shares Reserved**

Common stock reserved for future issuance was as follows:

	December 31,	
	2013	2012
Stock option grants outstanding (see Note 7)	1,659,170	1,624,188
Reserved for future stock option grants (see Note 7)	215,898	62,438
Reserved for note conversion (see Note 2)	1,050,325	620,844
Reserved for exercise of outstanding warrants (see Note 11)	1,033,776	607,776
	3,959,169	2,915,246

#### **NOTE 10 — Retirement Plan**

The Company has a tax-deferred savings plan, the Socket Mobile, Inc. 401(k) Plan (“401(k) Plan”), for the benefit of qualified employees. The 401(k) Plan is designed to provide employees with an accumulation of funds at retirement. Qualified employees may elect to make contributions to the 401(k) Plan on a monthly basis. No contributions were made by the Company during the years ended December 31, 2013 and 2012. Administrative expenses relating to the 401(k) Plan are not significant.

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)****NOTE 11 — Income Taxes**

Deferred tax expense is related to the deferred tax liability on the portion of the Company's goodwill amortized for tax purposes. Due to the indefinite characteristic of this deferred tax liability, it cannot be offset against deferred tax assets. The provision for deferred tax for the periods ended December 31, 2013 and 2012, consists of the following components:

	Years Ended December 31,	
	2013	2012
<u>Current:</u>		
Federal	\$—	\$—
State	—	—
Total Current	—	—
<u>Deferred:</u>		
Federal	31,939	31,940
State	—	—
Total Deferred	31,939	31,940
Total provision for deferred tax	\$31,939	\$31,940

Reconciliation of the statutory federal income tax rate to the Company's effective tax rate:

	Years Ended December 31,	
	2013	2012
Federal tax at statutory rate	34.00 %	34.00 %
State income tax rate	5.83 %	5.83 %
Losses and credits not benefited	(34.40%)	(38.85%)
Goodwill impairment	—	—
Provision for taxes	5.43 %	0.98 %

As of December 31, 2013, the Company did not recognize deferred tax assets relating to an excess tax benefit for stock-based compensation deduction of \$2,026,000. Unrecognized deferred tax benefits will be accounted for as a credit to additional-paid-in-capital when realized through a reduction in income taxes payable.

Deferred income tax reflects the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Significant components of net deferred tax assets are as follows:

—

56

Table of Contents**SOCKET MOBILE, INC.****NOTES TO FINANCIAL STATEMENTS (Continued)**

	Years Ended December 31,	
	2013	2012
Deferred tax assets:		
Net operating loss carryforwards	\$10,347,000	\$10,902,000
Credits	682,000	634,000
Capitalized research and development costs	295,000	446,000
Other acquired intangibles	165,000	184,000
Accruals not currently deductible	1,318,000	1,265,000
Total deferred tax assets	12,807,000	13,431,000
Valuation allowance for deferred tax assets	(12,788,334)	(13,417,395)
Net deferred tax assets	18,666	13,605
Deferred tax liability:		
Acquired intangibles	(130,000 )	(93,000 )
Net deferred tax liabilities	\$(111,334 )	\$(79,395 )

The Company has not generated taxable income in any periods in any jurisdiction, foreign or domestic. The Company has maintained a full valuation allowance for all deferred tax assets.

As of December 31, 2013, the Company had net operating loss carryforwards for federal income tax purposes of approximately \$28,884,000 which will expire at various dates beginning in 2017 and through 2033, and federal research and development tax credits of approximately \$414,000, which will expire at various dates beginning in 2018 and through 2033. As of December 31, 2013, the Company had net operating loss carryforwards for state income tax purposes of approximately \$21,612,000, which will expire at various dates in 2013 and through 2033, and state research and development tax credits of approximately \$268,000, which can be carried forward indefinitely. During 2013, approximately \$1,841,000 of federal net operating loss carryforwards expired unutilized.

Utilization of the net operating loss and tax credit carryforwards is subject to annual limitations due to the ownership change limitations provided by the Internal Revenue Code Section 382 and similar state provisions. The annual limitation will result in the expiration of the net operating loss and credit carryforwards before utilization. The deferred tax assets for the year ended December 31, 2013 reflect estimates of Section 382 limitations.

A reconciliation of the beginning and ending amount of unrecognized tax benefits (“UTBs”), excluding interest and penalties, is as follows:

	Amount
Beginning balance at January 1, 2013	\$633,000
Increases in UTBs taken in prior years	37,000
Increases in UTBs taken in current year	12,000
Amount related to settlements	—
Amount related to lapsing of statute of limitations	—
Ending balance at December 31, 2013	\$682,000

Future changes in the unrecognized tax benefit will have no impact on the effective tax rate due to the existence of the valuation allowance. It is the Company's policy to include interest and penalties related to tax positions as a component of income tax expense. No interest was accrued for the period ended December 31, 2013. The Company estimates that the unrecognized tax benefit will not change significantly within the next twelve months.

Table of Contents

**SOCKET MOBILE, INC.**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

The Company files its tax returns as prescribed by the tax laws of the jurisdictions in which it operates. The Company is not currently under audit in any of its jurisdictions where income tax returns are filed. The tax years 1996 to 2012 remain open to examination by the major domestic taxing jurisdictions to which the Company is subject, and for the years 2002 to 2009 for the international taxing jurisdictions to which the Company is subject.

On January 2, 2013, the President signed into law The American Taxpayer Relief Act of 2012 (“ATRA”). Under prior law, a taxpayer was entitled to a research tax credit for qualifying amounts incurred through December 31, 2011. The ATRA extends the research credit for two years for qualified research expenditures incurred through the end of 2013. The extension of the research credit is retroactive and includes amounts incurred after 2011. The Company estimates the benefit that it will receive as a result of the credit extension will be approximately \$24,321. The benefit, which will be subjected to a full valuation allowance, will be recognized in the period of enactment, which was the first quarter of 2013.

**NOTE 12 — Subsequent Events**

On January 8, 2014, the Company accepted the terms of a credit facility agreement with a new bank. The credit facility was activated and the transfer from the Company’s former bank was completed on March 7, 2014 (see “*New Bank Line of Credit*” within “NOTE 4 — Bank Financing Arrangements”).

On January 16, 2014, the Company issued 37,500 shares of common stock to a warrant holder in conjunction with a litigation settlement completed on December 28, 2013 (see “*Legal Matters*” within “NOTE 6 — Commitments and Contingencies” for more information).

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**



Not Applicable.

**Item 9A. 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 Annual Report on Form 10-K. 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.

—  
58

Table of Contents

*Management's Annual Report on Internal Control Over Financial Reporting*

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal control can provide only reasonable assurances with respect to financial statement preparation. Further, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2013. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework* issued in 1992. This assessment included review of the documentation of controls, testing of operating effectiveness of controls and a conclusion on this assessment.

Based on our assessment using those criteria, we believe that, as of December 31, 2013, our internal control over financial reporting is effective.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, which exempts non-accelerated filers from Section 404(b) of the Sarbanes-Oxley Act of 2002.

*Changes in Internal Control Over Financial Reporting*

There was no change in our internal control over financial reporting that occurred during the last fiscal quarter covered by this Annual Report on Form 10-K that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None.

—  
59

Table of Contents

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required hereunder is incorporated by reference from our Proxy Statement to be filed in connection with our annual meeting of stockholders to be held on May 15, 2014.

**Item 11. Executive Compensation**

The information required hereunder is incorporated by reference from our Proxy Statement to be filed in connection with our annual meeting of stockholders to be held on May 15, 2014.

**Item 12: Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Certain information required hereunder is incorporated by reference from our Proxy Statement to be filed in connection with our annual meeting of stockholders to be held on May 15, 2014.

The following table provides information as of December 31, 2013 about our common stock that may be issued under the Company's existing equity compensation plans. For additional information about the equity compensation plans see Note 7 to the Company's Financial Statements.

	Number of
	securities
Number of	remaining
Weighted-average	available

	securities to be issued	exercise price of outstanding options	for future issuance under equity compensation plans
Equity compensation plans approved by security holders (1)	1,659,170	\$ 2.29	215,898

(1) Consists of the 2004 Equity Incentive Plan. Pursuant to an affirmative vote by security holders in June 2004, an annual increase in the number of shares authorized under the 2004 Equity Incentive Plan is added on the first day of each fiscal year equal to the least of (a) 200,000 shares, (b) four percent of the total outstanding shares of the Company's common stock on that date, or (c) a lesser amount as determined by the Board of Directors. As a result, a total of 194,682 shares became available for grant under the 2004 Equity Incentive Plan on January 1, 2014, in addition to those set forth in the table above.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Certain information required hereunder is incorporated by reference from our Proxy Statement to be filed in connection with our annual meeting of stockholders to be held on May 15, 2014.

Table of Contents

**Item 14. Principal Accounting Fees and Services**

Certain information required hereunder is incorporated by reference from our Proxy Statement to be filed in connection with our annual meeting of stockholders to be held on May 15, 2014.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

(a) Documents filed as part of this report:

1. All financial statements.

INDEX TO FINANCIAL STATEMENTS	<u>PAGE</u>
Report of Sadler Gibb, Independent Registered Public Accounting Firm	33
Balance Sheets	34
Statements of Operations	35
Statements of Stockholders' Equity	36
Statements of Cash Flows	37
Notes to Financial Statements	38

2. Financial statement schedules.

All financial statement schedules are omitted because they are not applicable or not required or because the required information is included in the financial statements or notes herein.

3. Exhibits.

See Index of Exhibits on page 63. The Exhibits listed on the accompanying Index of Exhibits are filed or incorporated by reference as part of this report.

(b) Exhibits:

See Index of Exhibits on page 63. The Exhibits listed on the accompanying Index of Exhibits are filed or incorporated by reference as part of this report.

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61

Table of Contents

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, hereunto duly authorized.

SOCKET MOBILE, INC.  
Registrant

Date: March 28, 2014 /s/ Kevin J. Mills  
Kevin J. Mills  
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<u>/s/ Kevin J. Mills</u> Kevin J. Mills	President and Chief Executive Officer (Principal Executive Officer) and Director	March 28, 2014
<u>/s/ Charlie Bass</u> Charlie Bass	Chairman of the Board	March 28, 2014
<u>/s/ David W. Dunlap</u> David W. Dunlap	Vice President of Finance and Administration and Chief Financial Officer (Principal Financial and Accounting Officer)	March 28, 2014
<u>/s/ Leon Malmed</u> Leon Malmed	Director	March 28, 2014
<u>/s/ Peter Sealey</u> Peter Sealey	Director	March 28, 2014
<u>/s/ Charles C. Emery, Jr.</u> Charles C. Emery, Jr.	Director	March 28, 2014
<u>/s/ Kevin R. Jost</u> Kevin R. Jost	Director	March 28, 2014



/s/ Erik L. Fidel  
Erik L. Fidel

Director

March  
28,  
2014

Table of Contents

**Index to Exhibits**

<u>Exhibit Number</u>	<u>Description</u>
3.1 (1)	Amended and Restated Certificate of Incorporation.
3.2 (2)	Bylaws, as amended February 17, 2008.
10.1 (3)*	Form of Indemnification Agreement entered into between the Company and its directors and officers.
10.2 (4)*	2004 Equity Incentive Plan and forms of agreement thereunder.
10.3 (5)*	Form of Management Incentive Variable Compensation Plan between the Company and certain eligible participants.
10.4 (6)*	Standard Industrial /Commercial Multi-Tenant Lease by and between Del Norte Farms, Inc. and the Company dated October 24, 2006 (assigned to Newark Eureka Industrial Capital, LLC September 17, 2007).
10.5 (7)*	Second Amendment to Standard Industrial/Commercial Multi-Lessee Lease - Net dated August 30, 2010.
10.6 (8)*	Third Amendment to Standard Industrial /Commercial Multi-Tenant Lease - Net dated December 28, 2012.
10.7 (9)	Amended and Restated Securities Purchase Agreement between the Company and the investor listed on Exhibit A attached thereto dated November 19, 2010.
10.8 (9)	Senior Secured Convertible Note issued November 19, 2010 by the Company to the Investor.
10.9 (9)	Warrants for the Purchase of Shares of Common Stock Issued November 19, 2010 to the Investor and the Placement Agent in connection with a private placement.
10.10 (10)	Form of Employment Agreement dated March 8, 2012 between the Company and the officers of the Company.
10.11 (11)	Loan and Security Agreement dated February 27, 2014 by and between the Company and Bridge Bank, National Association.
11.1	Computation of Earnings per Share (see Statements of Operations in Item 8).

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Table of Contents

<u>Exhibit Number</u>	<u>Description</u>
14.1 (12)	Code of Business Conduct and Ethics.
23.1	Consent of Sadler Gibb & Associates, LLC, Independent Registered Public Accounting Firm.
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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\* Executive compensation plan or arrangement.

- (1) Incorporated by reference to exhibits filed with the Company's Form 10-K filed on March 16, 2009.
- (2) Incorporated by reference to exhibits filed with the Company's Form 8-K filed on February 20, 2008.
- (3) Incorporated by reference to exhibits filed with the Company's Form 8-K filed on January 27, 2009.
- (4) Incorporated by reference to Appendix C filed with the Company's Form DEF 14A filed on April 29, 2004.
- (5) Incorporated by reference to Appendix B filed with the Company's Form DEF 14A filed on March 16, 2011.
- (6) Incorporated by reference to exhibits filed with the Company's Form 10-Q filed on November 13, 2006.
- (7) Incorporated by reference to exhibits filed with the Company's Form 8-K filed on August 30, 2010.
- (8) Incorporated by reference to exhibits filed with the Company's Form 8-K filed on January 4, 2013.

Table of Contents

- (9) Incorporated by reference to exhibits filed with the Company's Form 8-K filed on November 19, 2010.
  
- (10) Incorporated by reference to exhibits filed with the Company's Form 8-K filed on March 8, 2012.
  
- (11) Incorporated by reference to exhibits filed with the Company's Form 8-K filed on March 7, 2014.
  
- (12) Incorporated by reference to exhibits filed with the Company's Form 10-K filed on March 10, 2006.