SOCKET MOBILE, INC.
Form 10-Q
August 11, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2014

OR

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

For the transition period _____ to _____.

Commission file number 1-13810

SOCKET MOBILE, INC.

(Exact name of registrant as specified in its charter)

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

39700 Eureka Drive, Newark, CA 94560

(Address of principal executive offices including zip code)

(510) 933-3000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [X]

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

The number of shares of Common Stock ($0.001 par value) outstanding as of August 1, 2014 was 4,931,125 shares.

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PART I

Item 1. Financial Statements

SOCKET MOBILE, INC.
CONDENSED BALANCE SHEETS

	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$702,465	$606,255
Accounts receivable, net	2,203,916	1,427,590
Inventories	727,756	1,105,088
Prepaid expenses and other current assets	205,630	93,647
Total current assets	3,839,767	3,232,580
Property and equipment:		
Machinery and office equipment	1,960,108	1,918,187
Computer equipment	1,024,096	1,059,943
	2,984,204	2,978,130
Accumulated depreciation	(2,750,487)	(2,683,193)
Property and equipment, net	233,717	294,937
Intangible assets, net	—	30,000
Goodwill	4,427,000	4,427,000
Other assets	117,518	117,518
Total assets	$8,618,002	$8,102,035
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$3,648,688	$3,489,311
Accrued payroll and related expenses	579,600	580,665
Bank line of credit	814,575	763,487
Deferred income on shipments to distributors	1,050,825	1,006,057
Related party and other short term notes payable	650,000	650,000
Related party convertible notes payable including related interest	406,323	418,482
Short term portion of deferred service revenue	158,780	172,474
Short term portion of capital leases and deferred rent	23,676	22,818
Total current liabilities	7,332,467	7,103,294
Related party convertible notes payable including related interest	429,932	393,980
Long term portion of deferred service revenue	102,744	95,049

Long term portion of capital leases and deferred rent	274,002	265,002
Deferred income taxes	127,304	111,334
Total liabilities	8,266,449	7,968,659
Commitments and contingencies		
Stockholders' equity:		
Common stock, $0.001 par value: Authorized – 20,000,000 shares, Issued and outstanding – 4,931,125 shares at June 30, 2014 and 4,867,063 shares at December 31, 2013	4,931	4,867
Additional paid-in capital	61,447,906	61,251,183
Accumulated deficit	(61,101,284)	(61,122,674)
Total stockholders' equity	351,553	133,376
Total liabilities and stockholders' equity	$8,618,002	$8,102,035

See accompanying notes.

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

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Revenues	$4,391,072	$4,435,431	$8,186,411	$8,700,606
Cost of revenues	2,490,507	2,630,841	4,662,786	5,187,931
Gross profit	1,900,565	1,804,590	3,523,625	3,512,675
Operating expenses:				
Research and development	586,371	594,140	1,140,057	1,118,890
Sales and marketing	526,834	585,088	1,002,780	1,144,287
General and administrative	511,827	448,695	1,032,750	909,757
Total operating expenses	1,625,032	1,627,923	3,175,587	3,172,934
Operating income	275,533	176,667	348,038	339,741
Interest expense and other, net	(113,234)	(125,173)	(249,178)	(205,460)
Loss on extinguishment of debt	(61,500)	—	(61,500)	—
Net income before income taxes	100,799	51,494	37,360	134,281
Income tax expense	(7,985)	(7,985)	(15,970)	(15,970)
Net income	$92,814	$43,509	$21,390	$118,311
Net income per share:				
Basic	$0.02	$0.01	$0.00	$0.02
Diluted	$0.02	$0.01	$0.00	$0.02
Weighted average shares outstanding:				
Basic	4,915,710	4,864,953	4,906,803	4,863,008
Diluted	5,162,197	4,987,156	4,961,413	4,946,155

See accompanying notes.

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

	Six Months Ended June 30,	
	2014	2013
Operating activities		
Net income	$21,390	$118,311
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Stock-based compensation	115,794	151,292
Depreciation and amortization	153,120	132,732
Deferred income tax expense	15,970	15,970
Loss on extinguishment of debt	61,500	—
Changes in operating assets and liabilities:		
Accounts receivable	(776,326)	(960,480)
Inventories	377,332	(91,099)
Prepaid expenses and other current assets	(111,983)	9,977
Accounts payable	208,170	(58,570)
Accrued payroll and related expenses	(1,065)	82,897
Deferred income on shipments to distributors	44,768	170,116
Deferred service revenue	(5,999)	(49,054)
Change in deferred rent	21,059	28,187
Net cash provided by (used in) operating activities	123,730	(449,721)
Investing activities		
Purchases of equipment	(61,900)	(41,860)
Net cash used in investing activities	(61,900)	(41,860)
Financing activities		
Payments on capital leases	(11,201)	(9,656)
Proceeds from borrowings under bank line of credit agreement	1,695,778	4,422,333
Repayments of borrowings under bank line of credit agreement	(1,644,690)	(4,087,966)
Stock options exercised	6,993	6,480
Warrants exercised	12,500	—
Proceeds from the issuance of related party and other short term notes payable	—	550,000
Repayment of short term note payable	—	(95,289)
Redemption of related party convertible note payable	(25,000)	(25,000)
Net cash provided by financing activities	34,380	760,902
Net increase in cash and cash equivalents	96,210	269,321
Cash and cash equivalents at beginning of period	606,255	390,513
Cash and cash equivalents at end of period	$702,465	$659,834

Supplemental cash flow information		
Cash paid for interest	$190,063	$163,998

See accompanying notes.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — Basis of Presentation

The accompanying unaudited condensed financial statements of Socket Mobile, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring accruals considered necessary for fair presentation have been included. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted.

These condensed financial statements should be read in conjunction with the audited financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The financial statements in the Company's annual report on Form 10-K were prepared on a going concern basis.

Liquidity and Going Concern

The Company was profitable in the quarter and six months ended June 30, 2014, but unprofitable in the quarter ended March 31, 2014. The Company was 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 in the amount of $620,493. As of June 30, 2014, the Company has an accumulated deficit of $61,101,284. The Company's cash balances at June 30, 2014 were $702,465, including $814,575 advanced on its bank lines of credit. At June 30, 2014, the Company had additional unused borrowing capacity of approximately $494,000 on its bank lines of credit. The Company's balance sheet at June 30, 2014 has a current ratio (current assets divided by current liabilities) of 0.5 to 1.0, and a working capital deficit of $3,492,700 (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 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, exercise of outstanding warrants and stock options, 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.

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(Unaudited)

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.

Reclassification of Financial Statement Accounts

Certain amounts in the December 31, 2013 financial statements have been reclassified to conform to the presentation in the June 30, 2014 financial statements.

NOTE 2 — Summary of Significant Accounting Policies

Use of Estimates

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

Cash Equivalents and Fair Value of Financial Instruments

The Company considers all highly liquid investments purchased with an original maturity date of 90 days or less at date of purchase to be cash equivalents. At June 30, 2014 and December 31, 2013, all of the Company's cash and cash equivalents consisted of amounts held in demand and money market deposits in banks. 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.

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(Unaudited)

NOTE 3 — Inventories

Inventories consist principally of raw materials and sub-assemblies, which are stated at the lower of cost (first-in, first-out) or market.

	June 30, 2014	December 31, 2013
Raw materials and sub-assemblies	$578,305	$1,045,356
Finished goods	149,451	59,732
	$727,756	$1,105,088

NOTE 4 — 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 (warrants 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. In April 2013, $25,000 of the original convertible notes were repaid. In September 2013, $350,000 of the notes were reissued as discussed previously. In April 2014, the remaining $25,000 of the original convertible notes was repaid. 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 the Company's bank. These convertible notes have been classified as short term on the Company's Condensed Balance Sheets at June 30, 2014 and December 31, 2013. Related accrued interest at June 30, 2014 and December 31, 2013 is $25,627 and $12,786, respectively.

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 (warrants 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 thereafter. Previously on November 5, 2012, the Company's Board of Directors approved the issuance 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 the Company's bank. These convertible notes have been classified as long term on the Company's Condensed Balance Sheets at June 30, 2014 and December 31, 2013. Related accrued interest at June 30, 2014 and December 31, 2013 is $58,003 and $22,051, respectively.

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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.

Interest expense related to all convertible subordinated notes for the three and six months ended June 30, 2014 was $26,527 and $52,213, respectively. Interest expense related to all convertible subordinated notes for the three and six months ended June 30, 2013 was $14,460 and $29,309, respectively. The related accrued interest at June 30, 2014 and December 31, 2013 was $83,630 and $34,837, respectively.

NOTE 5 — 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 June 30, 2014 and December 31, 2013, a total of $650,000 in funds were outstanding under this line, of which $450,000 and $50,000 respectively are from the Company’s Chairman and Chief Executive Officer. The line originally had an expiration date of December 1, 2013, which in November 2013 was extended to June 1, 2014. Interest accrued at the rate of 1% per week and was paid weekly through the maturity date of June 1, 2014. On May 15, 2014, the Company’s Board of Directors approved the issue of subordinated notes totaling $650,000 to replace the subordinated line of credit notes in the same amount maturing on June 1, 2014 mentioned previously. The new subordinated notes are two-year notes that mature on June 1, 2016, and are repayable by the Company at any time and have an interest rate of 18% per annum payable monthly in cash. Investors may request note repayment on or after October 1, 2014. $450,000 and $50,000 of the subordinated notes continue to be held by the Company’s Chairman and Chief Executive Officer, respectively. The Company extended the expiration date of 35,775 warrants originally issued to the outside investors on May 26, 2009 to June 1, 2016. These warrants were scheduled to expire on May 26, 2014. The warrants are exercisable into common stock at $1.80 per share. The Board approved stock option grants of 45,000 and 5,000 shares respectively for the Company’s Chairman and Chief Executive Officer. These stock options will vest monthly over a 24 month period.

The Company determined per ASC 470-50-40-10, that the present value of the cash flows under the terms of the replacement subordinated notes payable differed by more than 10 percent from the present value of the remaining cash flows of the subordinated notes being replaced. Therefore, debt extinguishment accounting rules apply. There was no

change in the net carrying value of the subordinated notes. However, the value of the options granted as consideration in connection with the issuance of the replacement subordinated notes was determined to be $61,500, of which the full amount was accordingly recorded as a loss on extinguishment of debt in the three month period ended June 30, 2014.

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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 for the three and six month periods ended June 30, 2014, related to the line of credit notes were $66,867 and $150,439 respectively. Interest expense for the three and six month periods ended June 30, 2013, related to the line of credit notes were $71,500 and $106,786 respectively.

NOTE 6 — Bank Financing Arrangements

On February 27, 2014, the Company entered into a new credit facility agreement with Bridge Bank (the "Bank"). The credit facility was activated and transfer of the credit facility from the Company's former bank was 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 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 Bank's prime rate (minimum of 3.25%) plus 1.5%. The annual interest rate in effect beginning March 7, 2014 is 4.75% per annum. There is also a collateral handling fee of 0.2% per month of the financed receivables outstanding. The applicable interest and fees are calculated based on the actual amounts borrowed. At June 30, 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 Bank's discretion and the Bank is not obligated to make advances. The agreement may be terminated by the Company or by the Bank at any time. The outstanding amounts borrowed under the domestic line at June 30, 2014 were $814,575. There were no amounts borrowed under the international line at June 30, 2014.

During 2013 and up through March 7, 2014, the Company had a credit facility agreement with Silicon Valley Bank (the "Former 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 through March 7, 2014 was 5%. 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. 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 amount borrowed at March 7, 2014 was $751,906, which was transferred to our new bank line of credit with Bridge Bank.

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(Unaudited)

Total interest expense on the amounts drawn under the Company's bank credit lines in effect during the three and six months ended June 30, 2014, was $14,891 and $39,010, respectively. Interest expense on the amounts drawn during the three and six months ended June 30, 2013 was $32,800 and $59,827, respectively. Accrued interest related to the amounts outstanding under the Company's bank lines of credit at June 30, 2014 and December 31, 2013 was $2,575 and $7,019, respectively.

NOTE 7 — Segment Information and Concentrations

Segment Information

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 were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Revenues:				
United States	$3,616,007	$3,226,442	$6,298,084	$5,804,072
Europe	489,303	611,185	1,234,373	1,484,332
Asia and rest of world	285,762	597,804	653,954	1,412,202
Total revenues	$4,391,072	$4,435,431	$8,186,411	$8,700,606

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.

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NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

Major Customers

Customers who accounted for at least 10% of the Company's total revenues in the three and six month periods ended June 30, 2014 and 2013 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Ingram Micro Inc.	35%	19%	34%	18%
ScanSource, Inc.	25%	21%	19%	20%
BlueStar, Inc.	18%	15%	17%	12%
Other company (through 2013)	n/a	*	n/a	11%

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

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk 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 June 30, 2014 and December 31, 2013 were as follows:

	June 30,	December 31,

	2014	2013
Company A	53%	43%
Company B	21%	28%
Company C	*	14%

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

Concentration of Suppliers

Several of the Company's component parts are produced by a sole or limited number of suppliers. Shortages could occur in these essential materials due to increased demand, or to an interruption of supply. Suppliers may choose to restrict credit terms or require advance payments causing delays in the procurement of essential materials. If the Company were unable to procure certain of such materials, it could have a material adverse effect upon its results. At June 30, 2014 and December 31, 2013, 20% and 28%, respectively, of the Company's accounts payable balances were concentrated in a single supplier. For the three months ended June 30, 2014, this and another supplier accounted for 63% of the inventory purchases.

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(Unaudited)

NOTE 8 — Stock-Based Compensation

The Company recognizes stock-based compensation in the financial statements for all share-based awards to employees, including grants of employee stock options, based on their fair values. The Company uses 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 Company's stock option grants. Total stock-based compensation expense for the three and six months ended June 30, 2014 was $63,548 and $115,794, respectively. Total stock-based compensation expense for the three and six months ended June 30, 2013 was $57,557 and $151,292, respectively. In the three and six months ended June 30, 2014, 89,200 and 293,300 stock options were granted at a weighted average per share fair values estimated at $1.11 and $0.78, respectively.

NOTE 9 — Net Income Per Share Applicable to Common Stockholders

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Numerator:				
Net income	$92,814	$43,509	$21,390	$118,311
Denominator:				
Weighted average common shares outstanding used in computing net income per share:				
Basic	4,915,710	4,864,953	4,906,803	4,863,008
Diluted	5,162,197	4,987,156	4,961,413	4,946,155
Net income per share:				
Basic	$0.02	$0.01	$0.00	$0.02

Diluted	$0.02	$0.01	$0.00	$0.02

NOTE 10 — Taxes

Income tax expense during the three and six months ended June 30, 2014 and 2013, and the deferred income tax amounts shown on the Company's Condensed Balance Sheets, is related entirely 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. As a result, the Company recognized deferred tax expense of $7,985 and $15,970, in each of the three and six month periods ended June 30, 2014 and 2013.

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NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

At December 31, 2013, the Company has an unrecognized tax benefit of approximately $682,000, which did not change significantly during the six months ended June 30, 2014. Future changes in the unrecognized tax benefit are unlikely to have an impact on the effective tax rate due to the full valuation allowance recorded on the Company's deferred tax assets, as realization of the deferred tax assets is dependent upon future taxable income.

NOTE 11 — 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.

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

Annual minimum payments:	Amount
2014 (July 1, 2014 to December 31, 2014)	$192,772
2015	393,255
2016	408,986
2017	425,345
2018 to 2022	2,132,136
Total minimum payments	$3,552,494

Rental expense under all operating leases was $107,403 and $214,468, for the three and six month periods ended June 30, 2014, respectively. Rental expense under all operating leases for the three and six month periods ended June 30, 2013 was $107,093 and $213,850, respectively. The amount of related deferred rent at June 30, 2014 and December 31, 2013 was $249,832 and $228,773, respectively.

Capital Lease Obligations

The Company leases certain of its equipment under capital leases. The leases are collateralized by the underlying assets. At June 30, 2014 and December 31, 2013, property and equipment with a cost of $87,945 were subject to such financing arrangements. Related accumulated amortization at June 30, 2014 and December 31, 2013, amounted to $40,099 and $28,898, respectively.

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SOCKET MOBILE, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

Future minimum payments under capital lease and equipment financing arrangements as of June 30, 2014, are as follows:

Annual minimum payments:	Amount
2014 (July 1, 2014 to December 31, 2014)	$13,233
2015	26,467
2016	11,916
Total minimum payments	51,616
Less amount representing interest	(3,770)
Present value of net minimum payments	47,846
Short term portion of capital leases	(23,676)
Long term portion of capital leases	$24,170

Purchase Commitments

As of June 30, 2014, the Company has non-cancelable purchase commitments for inventory to be used in the ordinary course of business of approximately $3,100,000.

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.

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

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include statements forecasting our future financial condition and results, our future operating activities, market acceptance of our products, expectations for general market growth of cordless barcode scanning, handheld computers, and other mobile 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-Q including "Item 1A. Risk Factors" and recent Form 8-K and Form 10-K reports filed with the Securities and Exchange Commission. We assume no obligation to update such forward-looking statements or to update the reasons why actual results could differ materially from those anticipated in such forward-looking statements.

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

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The Company

We are a producer of mobile cordless barcode scanners and handheld computers for the business mobility markets. 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. 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 1,000 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. Our mobile handheld computers are used in many hospitality and healthcare applications. We have more than 100 registered developers for our handheld computer.

We design our own products and then subcontract the manufacturing 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. We perform final product assembly and testing, and package and distribute our products at and from our Newark, California facility. Our data collection products and mobile handheld computers 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.

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 and mobile handheld computer 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.

Liquidity and Going Concern

We were profitable in the quarter and six months ended June 30, 2014, but unprofitable in the quarter ended March 31, 2014. 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 in the amount of $620,493. As of June 30, 2014, we have an accumulated deficit of $61.1 million. Our cash balances at June 30, 2014 were $0.7 million, including $0.8 million advanced on our bank lines of credit. At June 30, 2014, we had additional unused borrowing capacity of approximately $0.5 million on our bank lines of credit. Our balance sheet at June 30, 2014 has a current ratio (current assets divided by current liabilities) of 0.5 to 1.0, and a working capital deficit of $3.5 million (current assets less current liabilities). These circumstances raise substantial doubt about our ability to continue as a going concern.

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In the last three years 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 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 application development partners as they establish their mobile applications in key vertical markets. We believe 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, the exercise of outstanding warrants and stock options, 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 bank lines of credit may be terminated by the bank or by us at any time. If we cannot maintain profitability, we will not be able to support our operations from positive cash flows, and would use its existing cash to support operating losses. If we are unable to secure the necessary capital for its business, it may need to suspend some or all of our current operations.

If we can maintain revenue growth and attain ongoing 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.

The accompanying financial statements have been prepared assuming that we 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 our inability to continue as a going concern.

Products

We classify our primary products into two broad product families:

- Cordless barcode scanning products and related accessories and service;
- Mobile handheld computer products and related accessories and service;

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) imagers and linear (1D) laser and imager 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.

Mobile 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. We offer extended warranty programs for our mobile handheld computer products.

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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. Service revenues are included in the revenue totals for data collection products and handheld computer and data collection products as described in the table that follows further below.

Other

Other products include customized versions of our products we make available to original equipment manufacturers ("OEMs"), and upon request we also supply small quantities of discontinued legacy products when available.

Revenues

Total revenues for the three and six months ended June 30, 2014 were $4,391,000 and $8,186,000, respectively, an decrease of 1% and 6% from revenues of $4,435,000 and $8,700,000, respectively, in the comparable periods one year ago. Our revenues are classified into two primary product families. Additionally, we sell OEM embedded products to third parties, and we continue to carry legacy plug-in connectivity products. Our product revenues and the corresponding increase or decrease in revenues for the comparable periods are shown in the following table:

(revenues in thousands)	Three Months Ended June 30,			Six Months Ended June 30,		
Product family:	2014	2013	Increase (Decrease)	2014	2013	Increase (Decrease)
Cordless barcode scanning and related products and service	$3,738	$2,640	42 %	$6,650	$5,070	31 %
Mobile handheld computer and related products and service	640	1,666	(62 %)	1,488	3,114	(52 %)
Other	13	129	(90 %)	48	516	(91 %)
Total	$4,391	$4,435	(1 %)	$8,186	$8,700	(6 %)

Our *cordless barcode scanning and related products and service* revenues in the three and six months ended June 30, 2014 were $3.7 million and $6.7 million, an increase of 42% and 31% compared to revenues of $2.6 million and $5.1

million in the comparable periods one year ago. Revenue increases totaling $0.6 million and $0.9 million in the three and six month periods ending June 30, 2014 were from increased sales volumes of our Apple certified Series-7 high performance 1D cordless handheld barcode scanners compared to the same periods a year ago. Revenue increases totaling $0.4 million in both the three and six month comparable periods were from increased sales volumes of our Apple certified entry level cordless handheld scanners. Revenue increases of $0.1 million and $0.3 million in the comparable three and six month comparable periods were from increased sales volumes of our Series-8 cordless scanner optimized for use with smartphones and tablets.

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Our *mobile handheld computer and related products and service* revenues in the three and six months ended June 30, 2013 were $0.6 million and $1.5 million, a decrease of 62% and 52% compared to revenues of $1.7 million and $3.1 million in the corresponding periods one year ago. Mobile handheld computer revenues (excluding revenues from the related plug-in products, accessories, and services) declined by $0.7 million and $1.2 million in the three and six months ended June 30, 2014 reflecting lower overall sales volumes compared to the same periods one year ago. Remaining declines in the comparable three and six month periods were primarily 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 declines in sales of related mobile handheld computer accessories and services, also reflective of the overall lower unit sales volumes of our mobile handheld computers in the three and six months periods ended June 30, 2014 compared to the same periods one year ago. Sales of our mobile computer 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. Additionally, 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.

Service revenues were 3% of our revenues in the second quarter of 2014 and 2013. Service revenues were 4% of our revenues in the first half of 2014 and 2013. The majority of our SocketCare service contracts are purchased by our customers in conjunction with the purchase of mobile handheld computers. Service revenues have been allocated to the respective products serviced in the table above.

Other revenues in the three and six months ended June 30, 2013 were $13,000 and $48,000, a decrease of 90% and 91% compared to revenues of $129,000 and $516,000 in the corresponding periods one year ago. Revenue decreases reflect diminishing sales of legacy products and sales to OEM customers in the comparable three and six month periods.

Gross Margins

Our gross margins in the three and six months ended June 30, 2014 were 43% in both, compared to margins of 41% and 40% in the corresponding periods one year ago. 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 the three and six months ended June 30, 2014 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, combined margin improvements on each of these product lines in the comparable periods.

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Research and Development Expense

Research and development expense in the three months ended June 30, 2014 was $586,000, a decrease of 1% compared to $594,000 in the corresponding period one year ago. Research and development expense for the six months ended June 30, 2014 was $1,140,000, an increase of 2% compared to research and development expense of $1,119,000 in the corresponding period one year ago. Decreases in the level of research and development expense in the comparable three month periods were primarily due to decreases in equipment costs, partially offset by higher personnel costs compared to same period a year ago reflecting compensation increases which were phased in during the second quarter 2014. Increases in the level of research and development expense in the comparable six month periods were primarily due to higher personnel costs compared to personnel costs a year ago reflecting compensation expense savings programs initiated in late 2012 and in effect through the first quarter of 2013, combined with the compensation adjustments phased in during the second quarter 2014 mentioned previously. Partially offsetting these increases was a decrease in equipment costs compared to the same six month period one year ago. Research and development expense in the third quarter of 2014 is expected to moderately increase from second quarter levels.

Sales and Marketing Expense

Sales and marketing expense in the three months ended June 30, 2014 was $526,000, a decrease of 10% compared to $585,000 in the same period one year ago. Sales and marketing expense in the six months ended June 30, 2014 was $1,003,000, a decrease of 12% compared to $1,144,000 in the same period one year ago. Decreases in sales and marketing expense in the comparable three and six month periods were due primarily to declines in personnel costs due to lower overall headcount in the comparable periods. Additional declines were from reductions in travel related expenses and advertising and promotional expenditures, partially offset by increases in outside services expense. Sales and marketing expense in the third quarter of 2014 is expected to moderately increase from second quarter levels.

General and Administrative Expense

General and administrative expense in the three months ended June 30, 2014 was $512,000, an increase of 14% compared to $449,000 in the same period one year ago. General and administrative expense in the six months ended June 30, 2014 was $1,033,000, an increase of 14% compared to $910,000 in the same period one year ago. Increases in the three and six month comparable periods were primarily due to higher personnel costs compared to a year ago reflecting compensation expense savings programs initiated in late 2012 and in effect through the first quarter 2013, combined with compensation increases which were phased in during the second quarter 2014. General and administrative expense is expected to moderately increase in the third quarter of 2014 from second quarter levels.

Interest Expense and Other, Net of Interest Income and Other

Interest expense and other, net of interest income and other, in the three and six months ended June 30, 2014 was $113,000 and $249,000, respectively, compared to $125,000 and $205,000, respectively, in the same periods one year ago.

Interest expense in each of the comparable periods was related primarily to interest on our notes payable, interest on our convertible notes payable issued in 2012 and reissued in September of 2013, and interest on amounts drawn on our bank lines of credit (see “NOTE 4 — Related Party Convertible Notes Payable” and “NOTE 5 — Related Party and Other Short Term Notes Payable” for more information). Additionally, interest expense in each of the comparable periods presented includes interest on equipment lease financing obligations. Lower interest expense in the comparable second quarters reflects lower interest rates on our new bank line of credit effective March 7, 2014 compared to our previous bank line of credit, and lower interest expense related to our subordinated notes as a result of lower interest rates in effect on the reissued two-year subordinated notes which replaced the previous notes maturing on June 1, 2014. Higher interest expense in the comparable six month periods reflects higher overall note balances in effect for the 2014 six month period, partially offset by lower interest expense on our new bank line of credit mentioned previously.

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Interest income and other reflects interest earned on cash balances. Interest income was nominal in each of the comparable first quarters, reflecting low average cash balances combined with low average rates of return. 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 in the three and six months ended June 30, 2014 and 2013, 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.

Cash Flows and Contractual Obligations

As reflected in our Statements of Cash Flows, net cash provided by operating activities was $124,000 in the first half of 2014, compared to net cash used in operating activities of $450,000 in the comparable period a year ago. We calculate net cash provided by or used in operating activities by increasing our net income ($21,000 and $118,000 in the first half of 2014 and 2013, respectively) by those expenses that did not require the use of cash, and reversing gains or losses that did not generate or use cash. These items consist of stock based compensation expense, depreciation, amortization of intangible assets, deferred tax expense, and in the second quarter of 2014 the loss on extinguishment of debt. These amounts totaled $346,000 and $300,000 in the first half of 2014 and 2013, respectively. In addition, we report increases in assets and reductions in liabilities as uses of cash and decreases in assets and increases in liabilities as sources of cash, together referred to as changes in operating assets and liabilities. In the first half of 2014 changes in operating assets and liabilities resulted in a net use of cash of $244,000 and were primarily from increases in accounts receivable due to the increased level of customer shipments in the second quarter 2014 compared to the fourth quarter 2013, increases in prepaid expenses related to service and insurance renewals, and prepayments for inventory. These uses of cash in the first half of 2014 were partially offset by reductions in inventory levels related to our scanning and mobile handheld computer product lines, and increases in accounts payable due to the timing of vendor payments. In the first half of 2013 changes in operating assets and liabilities resulted in a net use of cash of $0.9 million and were primarily from net increases in accounts receivable due to higher overall shipments to our distributors in the second quarter of 2013 compared to the fourth quarter of the prior year. Additional uses in the first half of 2013 were from increases in inventory and decreases in accounts payable. These uses of cash were partially offset by increases in the inventory levels in our distribution channel due to the higher shipments just mentioned, and increases in accrued payroll and related expenses due primarily to the elimination of salary reduction programs at the beginning of the second quarter 2013.

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Cash used in investing activities was $62,000 in the first half of 2014 compared to $42,000 in the first half of 2013. Investing activities in the first half of 2014 was related primarily to expenditures on tooling related to our scanning product line, and purchases of computer equipment. Investing activities in the first half of 2013 is related to primarily to expenditures on product tooling and purchases of computer equipment.

Cash provided by financing activities was $34,000 in the first half of 2014 compared to cash provided by financing activities of $761,000 in the first half of 2013. Financing activities in the first half of 2014 consisted primarily of net amounts advanced on our bank lines of credit and proceeds from the exercise of stock options and warrants, partially offset by a related party convertible note holder redemption. The proceeds from and repayments of borrowings in the first half of 2014 as shown on our Condensed Statement of Cash Flows excludes $752,000 related to the amounts outstanding under the credit line with our former bank which was transferred to our new bank on March 7, 2014 (see “NOTE 6 — Bank Financing Arrangements” for more information). Financing activities in the first half of 2013 consisted primarily of proceeds from the issuance of related party and other short term notes payable in the first quarter of 2013 and net amounts advanced on our bank lines of credit, partially offset by repayment of a short term note originally advanced on August 31, 2012 with final repayment completed in January 2013, and a related party convertible note holder redemption.

Our contractual cash obligations at June 30, 2014 are outlined in the table below:

		Payments Due by Period			
Contractual Obligations	Total	Less than 1 year	1 to 3 years	4 to 5 years	More than 5 years
Unconditional purchase obligations with contract manufacturers	$3,084,000	$3,084,000	$—	$—	$—
Operating leases	3,553,000	386,000	818,000	885,000	1,464,000
Short term notes payable	650,000	650,000	—	—	—
Capital leases	48,000	24,000	24,000	—	—
Total contractual obligations	$7,335,000	$4,144,000	$842,000	$885,000	$1,464,000

We have outstanding amounts borrowed under our lines of credit with Bridge Bank at June 30, 2014 of approximately $815,000. Accrued interest related to the amounts outstanding at June 30, 2014 was approximately $3,000. The credit facility agreement expires on February 27, 2016 unless renewed. The agreement may be terminated by us 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 are at the Bank’s discretion and the Bank is not obligated to make advances.

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Additionally, at June 30, 2014 we had outstanding a total of $836,000 in subordinated convertible notes including accrued interest issued to select officers and directors of the Company. $406,000 of these notes have a term of four years that accrue interest at 8% per annum compounded quarterly, mature on September 4, 2017, and have a note holder call provision that becomes effective on September 4, 2014. $430,000 of the notes have a term of four years that accrue interest at 18% per annum compounded quarterly, mature on September 4, 2017, and do not have a call provision. Accrued interest for all convertible notes is payable upon redemption. The 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, or at $1.25 per share for the four-year notes, if these warrants are no longer outstanding. The warrants issued on November 19, 2012 expire on May 20, 2016. Accrued interest expense at June 30, 2014 for all convertible notes outstanding was approximately $84,000. 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 Bridge Bank.

Off-Balance Sheet Arrangements

As of June 30, 2014, we have no off-balance sheet arrangements as defined in Item 303 of Regulation S-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to 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 June 30, 2014, a decline of 1% in interest rates would not have had a material effect on our quarterly interest income. Our bank credit line facilities (effective March 7, 2014) of up to $2.5 million have variable interest rates based upon the lender's prime rate (minimum of 3.25%) plus 1.5%, 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 June 30, 2014, an increase of 1% in the interest rate would have increased our quarterly borrowing costs by approximately $2,000.

Foreign Currency Risk

A substantial majority of our revenue, expense and purchasing activities are transacted in U.S. dollars. However, we require our European distributors to purchase our products in Euros and we pay the expenses of our European

employees in Euros and British pounds. We may enter into selected future purchase commitments with foreign suppliers that may be paid in the local currency of the supplier. We hedge a significant portion of our European receivables balance denominated in Euros to reduce the foreign currency risk associated with these assets, and we have not been subject to significant losses from material foreign currency fluctuations. Based on a sensitivity analysis of our net foreign currency denominated assets and expenses at the beginning, during and at the end of the quarter ended June 30, 2014, an adverse change of 10% in exchange rates would have resulted in a decrease in our net income for the second quarter 2014 of approximately $18,000 if left unprotected. For the second quarter of 2014, 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 $4,000. We will continue to monitor, assess, and mitigate through hedging activities, our risks related to foreign currency fluctuations.

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Item 4. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the period covered by the last fiscal quarter ended June 30, 2014 and this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II

Item 1A. Risk Factors

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

Our ability to continue as a going concern is dependent upon our ability to maintain 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 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 continue 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, the exercise of outstanding warrants and stock options, 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 unprofitable in the first quarter of 2014, profitable in the second quarter 2014, and profitable in the first half of 2014, but only to the extent of $21,000. 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.

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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.

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

We are dependent upon application developers to integrate our scanning and software products into their applications designed for mobile workers using smartphones, tablets and mobile computers, and to successfully market and sell those application products and solutions into the marketplace. We focus on serving the needs of application developers as sales of our 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, 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.

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.

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

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

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

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

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.

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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.

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 markets 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.

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.

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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.

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. Ingram Micro Inc., ScanSource, Inc., and BlueStar, Inc., together represented approximately 70% and 55%, respectively, of our worldwide revenues in the first half of 2014 and fiscal year 2013. 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.

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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.

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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.

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, 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, or Google is obligated to collaborate or to support the products produced from such collaboration. Consequently, these organizations may terminate their collaborations with us for a variety of reasons, including our failure to meet agreed-upon standards or for reasons beyond our control, such as changing market conditions, increased competition, discontinued product lines, and product obsolescence.

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

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

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

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

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

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

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

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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.

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.

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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.

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 23% and 30% of our revenues in first half of 2014 and fiscal year 2013, 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.

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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.

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 August 1, 2014, we had 4,931,125 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.

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As of August 1, 2014, we had 1,937,384 shares of common stock subject to outstanding options under our stock option plans, and 125,804 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.

As of August 1, 2014, we had 35,775 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 August 1, 2014, we had 1,016,000 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 August 1, 2014, we had $845,889 in subordinated convertible notes payable including related accrued interest. Up to 977,400 shares of common stock could be issued for conversion of the notes plus all accrued interest thru the maturity date of 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 August 1, 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.

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Item 6. Exhibits

Exhibits

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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

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SIGNATURES

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

SOCKET MOBILE, INC.

Registrant

Date: August 11, 2014 /s/ Kevin J. Mills
Kevin J. Mills
President and Chief Executive Officer
(Duly Authorized Officer and Principal Executive Officer)

Date: August 11, 2014 /s/ David W. Dunlap
David W. Dunlap
Vice President of Finance and Administration and Chief Financial Officer (Duly Authorized Officer and Principal Financial and Accounting Officer)

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Index to Exhibits

Exhibit Number	Description
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