

Consolidated Financial Statements and Report of
Independent Certified Public Accountants

mBlox, Inc.

December 31, 2013 and 2012

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Report of Independent Certified Public Accountants

Board of Directors and Stockholders
mBlox, Inc.

We have audited the accompanying consolidated financial statements of mBlox, Inc. (a Delaware corporation) and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

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

Grant Thornton LLP

Atlanta, Georgia

May 14, 2014

Consolidated balance sheets

<i>In thousands, except share price</i>	December 31,	
	2013	2012
Assets		
Current assets		
Cash and cash equivalents	\$ 8,575	\$ 22,034
Accounts receivable, net of allowance and reserves of \$2,163 and \$3,988 as of December 31, 2013 and 2012, respectively	26,923	40,884
Prepaid expenses and other current assets	4,255	3,124
Total current assets	39,753	66,042
Non-current assets		
Property and equipment, net	3,409	7,034
Intangible assets, net	-	3,347
Goodwill	7,048	7,048
Deferred tax assets	8,285	386
Other non-current assets	2,995	299
Total non-current assets	21,737	18,114
Total assets	\$ 61,490	\$ 84,156
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 3,556	\$ 2,213
Accrued compensation and benefits	2,398	2,323
Accrued premium rate short message service payments	3,604	31,341
Accrued standard rate message operator costs	22,004	21,298
Debt	-	14,450
Warrant liabilities	1,407	1,601
Other accrued liabilities	211	2,874
Total current liabilities	33,180	76,100
Non-current liabilities		
Debt, long term	17,000	-
Other Liabilities	1,211	1,267
Non-current liabilities	18,211	1,267
Total liabilities	\$ 51,391	\$ 77,367
Commitments and contingencies (Note 7)		
Stockholders' equity		
Convertible preferred stock, \$0.001 par value; 408,539 shares authorized as of December 31, 2013 and 2012, and 217,415 issued and outstanding as of December 31, 2013 and 2012 (aggregate liquidation preference of \$71,611)	\$ 217	\$ 217
Convertible preferred stock, \$0.00001 par value; 69,327 shares authorized, 65,823 issued and outstanding at December 31, 2013 and 2012 (aggregate liquidation preference of \$18,376)	1	1
Class 1 Common stock, \$0.001 par value; 694,000 shares authorized as of December 31, 2013 and 2012, 176,715 and 176,300 issued and outstanding as of December 31, 2013 and 2012, respectively	177	176
Class 2 Common stock, \$0.00001 par value; 75,000 shares authorized, and 5,954 issued and outstanding at December 31, 2013 and 2012	-	-
Additional paid-in capital	112,096	111,338
Accumulated other comprehensive loss	(6,095)	(5,036)
Accumulated deficit	(96,297)	(99,907)
Total stockholders' equity	\$ 10,099	\$ 6,789
Total liabilities and stockholders' equity	\$ 61,490	\$ 84,156

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

Consolidated statements of operations

<i>In thousands</i>	Years ended December 31,	
	2013	2012
Net revenues	\$ 140,111	\$ 139,341
Costs and operating expenses		
Cost of revenue - service delivery	94,610	89,574
Cost of revenue - operations	9,474	11,759
Research and development	5,941	6,212
Sales and marketing	14,368	16,582
General and administrative	11,158	11,720
Depreciation and amortization	9,132	5,887
Restructuring expenses	1,883	12,369
Total costs and operating expenses	146,566	154,103
Loss from operations	\$ (6,455)	\$ (14,762)
Interest income	5	22
Interest expense	(1,945)	(967)
Change in fair value of warrant liabilities	430	118
Foreign exchange gains, net	1,598	435
Other (expense) income	(22)	19
Loss before income taxes	(6,389)	(15,135)
Income tax benefit	(9,999)	(50)
Net income (loss)	\$ 3,610	\$ (15,085)

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

Consolidated statements of comprehensive income (loss)

<i>In thousands</i>	Years ended December 31,	
	2013	2012
Net income (loss)	\$ 3,610	\$ (15,085)
Other comprehensive loss:		
Foreign currency translation	(1,059)	(433)
Total other comprehensive loss	(1,059)	(433)
Comprehensive income (loss)	\$ 2,551	\$ (15,518)

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

Consolidated statements of changes in stockholders' equity

<i>In thousands</i>	Voting Convertible Preferred Stock		Non-voting Convertible Preferred Stock		Class 1 Common Stock		Class 2 Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Accumulated		Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount		Loss	Deficit	
	Balance as of December 31, 2011	283,238	\$ 283	-	\$ -	181,845	\$ 182	-		\$ -	\$110,622	
Issuance of common stock upon exercise of options	-	-	-	-	219	-	-	-	10	-	-	10
Stock-based compensation expense	-	-	-	-	-	-	-	-	594	-	-	594
Conversion of Series A-1, A-2, C-1, D-1, E-1, F to non-voting preferred stock	(65,823)	(66)	65,823	1	-	-	-	-	65	-	-	-
Conversion of Class 1 Common Stock to Class 2 Common Stock	-	-	-	-	(5,954)	(6)	5,954	-	6	-	-	-
Issuance of common stock for MashMobile contingent consideration	-	-	-	-	190	-	-	-	41	-	-	41
Foreign currency translation, net of taxes	-	-	-	-	-	-	-	-	-	(433)	-	(433)
Net loss	-	-	-	-	-	-	-	-	-	-	(15,085)	(15,085)
Balance as of December 31, 2012	217,415	217	65,823	1	176,300	176	5,954	-	111,338	(5,036)	(99,907)	6,789
Issuance of common stock upon exercise of options	-	-	-	-	288	1	-	-	4	-	-	5
Stock-based compensation expense	-	-	-	-	-	-	-	-	487	-	-	487
Stock-based compensation expense for stock option modifications	-	-	-	-	-	-	-	-	245	-	-	245
Issuance of common stock for MashMobile contingent consideration	-	-	-	-	127	-	-	-	22	-	-	22
Foreign currency translation, net of taxes	-	-	-	-	-	-	-	-	-	(1,059)	-	(1,059)
Net income	-	-	-	-	-	-	-	-	-	-	3,610	3,610
Balance as of December 31, 2013	217,415	\$ 217	65,823	\$ 1	176,715	\$ 177	5,954	\$ -	\$112,096	\$ (6,095)	\$ (96,297)	\$ 10,099

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

Consolidated statements of cash flows

<i>In thousands</i>	Years ended December 31,	
	2013	2012
Operating activities		
Net income (loss)	\$ 3,610	\$ (15,085)
Adjustments to reconcile net income (loss) to net cash (used) provided by operating activities:		
Depreciation and amortization	9,132	5,887
Stock-based compensation expense	733	594
Amortization of debt discount	384	-
Change in fair value of warrants	(430)	(118)
Loss on the disposal of property and equipment	69	10,614
Provision for doubtful accounts	569	652
Deferred tax benefit	(9,905)	-
Changes in operating assets and liabilities:		
Accounts receivable	14,225	20,527
Prepaid expenses and other assets	(2,275)	2,015
Accounts payable	1,243	2,230
Accrued compensation and benefits	40	(1,410)
Accrued premium rate short message service payments	(28,458)	(3,066)
Accrued standard rate message operator costs	355	(778)
Other liabilities	(3,016)	(4,537)
Net cash (used) provided by operating activities	(13,724)	17,525
Investing activities		
Purchase of property and equipment	(784)	(3,626)
Capitalized software costs	(1,367)	(3,436)
Net cash used in investing activities	(2,151)	(7,062)
Financing activities		
Proceeds from debt obligations	17,000	-
Payments for debt obligations	(14,450)	(2,374)
Proceeds from exercise of employee common stock options	5	50
Net cash provided by (used in) financing activities	2,555	(2,324)
Effect of foreign currency changes on cash and cash equivalents	(139)	(433)
Net (decrease) increase in cash and cash equivalents	(13,459)	7,706
Cash and cash equivalents, beginning of year	22,034	14,328
Cash and cash equivalents, end of year	\$ 8,575	\$ 22,034
Supplemental cash flow information		
Cash paid for interest, net	\$ 2,314	\$ 822
Cash received for income taxes, net	\$ 76	\$ 40
Non-cash investing and financing activities		
Accounts payable related to property and equipment purchases	\$ 86	\$ 22

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

Notes to consolidated financial statements

Note 1 – Organization

mBlox, Inc. was incorporated under the laws of the State of Delaware in 1999. mBlox, Inc., together with its wholly owned subsidiaries (collectively, the “Company” or “mBlox”) is a mobile network service provider that accelerates mobile commerce by enabling rich mobile interaction and communication between brands and consumers. The Company manages the transmission, mobile billing, and financial settlement of Short Message Service (“SMS”) mobile messaging, or text messaging as it is commonly referred. The Company provides easy access to mobile subscribers and transmits a broad variety of rich content and secure messages to a wide range of customers, including financial institutions, transportation firms, media companies, and consumer brands. The Company’s customers are primarily in Europe and North America.

In March 2013, the Company sold to OpenMarket Inc. (“OpenMarket”) the customer contracts and related commitments for the Premium Rate Short Message Service (“PSMS”) product line in the U.S., U.K., Australia and Ireland, representing nearly all of the Company’s PSMS product line. Please refer to Note 12 for further discussion of the transaction.

Note 2 – Significant accounting policies

Principles of consolidation and basis of presentation

The consolidated financial statements include the accounts of the Company, including its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated. References to “2013” and “2012” refer to the year ended on December 31. Certain reclassifications have been made to the prior years’ financial statements to conform to current year presentation in the Company’s balance sheet.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, and reported amounts of revenue and expenses during the reporting period. Actual results could differ materially from those estimates.

Revenue recognition

The Company derives revenue from sending SMS messages between applications and mobile phones or other SMS-enabled devices and enabling the billing mechanism for these transactions for content providers and enterprises. Standard rate messages are sent between an enterprise and a mobile user’s SMS-enabled device. The Company charges fees for message volume as well as account setup and monthly fees. PSMS messages are sent from a content provider to a mobile user’s SMS-enable device containing content requested by the mobile user. PSMS messaging allows the content providers to reach subscribers and monetize their content. For example, content providers are able to deliver games, traffic alerts, and banking, sports and news updates.

Mobile operators facilitate the transport and billing of the PSMS messages to the mobile user. Mobile operators remit payment to the Company upon settlement of the PSMS transactions. The Company then remits an outpayment to the content provider for the amounts received from the mobile operators, net of the Company’s fee for the PSMS transaction.

The Company recognizes revenue when all of the following conditions are satisfied: (i) there is persuasive evidence of an arrangement; (ii) the service has been rendered or delivery has occurred; (iii) the fee to be paid by the customer is fixed or determinable; and (iv) collection of the fee is reasonably assured.

Standard rate message revenue is recognized upon sending the messages to the mobile user. Customers are typically billed monthly for standard rate messages in the month following the message delivery. Some customers are required to pre-pay for standard rate messages. In the event the customer prepays for standard rate messages, the revenue is deferred until the messages have been sent.

For PSMS messages, the Company acts as an agent between mobile operators and content providers and records revenue for the payments received from mobile operators, net of payments the Company makes to content providers. PSMS revenue is recognized when service is rendered and billed in arrears.

Both standard rate and PSMS revenue include customer set up and customer support fees that are recognized ratably over the expected life of the arrangement for the customer, which is estimated as one year. In addition, the Company may obtain shortcodes (unique identifier for a mobile service) from the shortcode registry on behalf of a customer that is then invoiced to the customer and recognized over the period of registry, typically several months.

In the event that the content provider makes a prepayment for any services, the revenue is deferred until the services have been performed.

The Company records reductions to revenue for estimated refunds. Refunds are mainly a result of price adjustment credits in response to individual competitive opportunities and billing errors. Allowance for refunds are estimated based on historical refunds, current trends, and the Company's expectations regarding future experience. The Company monitors and analyzes the accuracy of refund estimates by reviewing actual refunds and adjusts them for future expectations to determine the adequacy of the Company's current and future allowance needs. The Company's allowance levels have been sufficient to cover actual refunds and have not required material changes in subsequent periods. While the Company currently has no expectations for significant changes to these allowance, if actual future refunds differ from past experience, adjustments may be required.

Cost of revenue - service delivery and Cost of revenue - operations

Cost of revenue - service delivery primarily consists of fees paid to mobile operators to transmit messages or content traffic across their networks, which are referred to as traffic cost. Other costs in this category applicable to both standard rate and PSMS messages include setup fees paid to mobile operators to establish an account; shortcode fee costs paid by the Company to procure or renew a shortcode on behalf of customers; end-user support costs incurred while providing customer service to subscribers who are billed on behalf of the content providers; and network-related costs incurred by the Company to operate and maintain its message processing, transmission, and billing platform.

Cost of revenue - operations primarily consists of expenses incurred related to delivering product to customers, which include customer service and support, billing, provisioning, service implementation, and network management, or applications support.

Cash and cash equivalents

Cash and cash equivalents include cash balances and highly liquid investments with a maturity of three months or less at the date of acquisition. The Company maintains cash balances in excess of the Federal Deposit Insurance Corporation insured amount in cash equivalents in high-credit-quality financial institutions. The Company had \$5.3 million of cash and cash equivalents in banks outside of the U.S. as of December 31, 2013.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of cash, cash equivalents, and accounts receivable. The Company generally does not require its customers to provide collateral or other security to support accounts receivable. To reduce credit risk, management performs ongoing credit evaluations of its customers' financial condition and continually analyzes the collectability of its receivables based on a combination of factors. The Company had no customers to whom accounts receivable and sales were in excess of 10% of accounts receivables or total annual revenue, respectively, as of December 31, 2013 and 2012.

Accounts receivable

Accounts receivables are reported at outstanding principal net of an allowance for doubtful accounts and a reserve for customer concessions and billing adjustments. The allowance for doubtful accounts is generally determined based on aged accounts and an account-by-account review based on estimates developed using standard quantitative measures, which include historical write offs, current economic conditions and relevant customer specific information. The Company also makes a specific allowance if there is strong evidence indicating that the amounts due are unlikely to be collectible. Accounts are written off when the account is deemed uncollectible. The reserve for customer concessions and billing adjustments is generally based on historical trends by product. The reserve is utilized via credit notes. The Company normally does not charge interest on accounts receivable.

Accounts receivable balances include approximately \$2.3 and \$16.7 million related to the Company's PSMS business as of December 31, 2013 and 2012, respectively. Please refer to Note 12 for further discussion of the PSMS business and sale of the PSMS contracts in 2013.

Property and equipment

Property and equipment consists mainly of computer software, computer equipment, furniture and fixtures, leasehold improvements, and work in progress, and are recorded at historical cost net of accumulated depreciation and amortization. The Company depreciates computer software, computer equipment, and furniture and fixtures using the straight-line method over the estimated useful lives of the asset, generally three to five years. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the assets. Work in process is not amortized until placed into service.

Gains and losses on disposal of property and equipment are determined by comparing proceeds with the carrying value of the respective asset, and are included in income from operations. All maintenance and repairs are expensed as incurred.

The Company capitalizes costs related to software developed for new internal use software and significant enhancements of existing internal use software once technological feasibility has been reached and all research and development for the components of the product have been completed. Capitalized internal use software development costs consist primarily of internal salaries and consulting fees for developing software platforms for delivery of standard rate message and PSMS services. The Company capitalizes costs related to the development of its software products, as all of the products are to be used for product offerings. Such software is primarily related to the Company's platform, including underlying support systems. Such costs are amortized on a straight-line basis over the estimated useful life of the related product, not to exceed five years, commencing with the date the product becomes available for general release to the Company's customers. The achievement of technological feasibility and the estimate of a products' economic life require management's judgment. Any changes in key assumptions, market conditions or other circumstances could result in an impairment of the capitalized asset and a charge to the Company's operating results.

Intangible assets

Intangible assets are reported at cost less accumulated amortization and accumulated impairment loss, if any. Amortization is expensed on a straight-line basis over the estimated economic lives of the assets acquired. The estimated economic life of acquired assets is initially determined at date of acquisition and reviewed at each annual reporting date, with the effect of any changes in estimate being accounted for on a prospective basis. Acquired in-process technology represents the estimated fair value assigned to research and development acquired in a purchase business combination that has not been completed at the date of acquisition.

Goodwill

Goodwill is generated when the consideration paid for an acquisition exceeds the fair value of net assets acquired. Goodwill is not amortized but reviewed for impairment on an annual basis, or whenever events or circumstances indicate that the carrying amount of goodwill may not be recoverable. The Company performs the annual impairment testing of goodwill as of October 1 each year. The Company determined that no goodwill impairment charge was necessary for 2013 and 2012.

Operating leases

Leases are classified as operating leases where a significant portion of the risks and rewards of ownership are retained by the lessor. Payments made under operating leases are charged to the consolidated statement of operations on a straight-line basis over the term of the lease.

Income taxes

The provision for income taxes is recorded using the asset and liability method of accounting. Under this method, deferred tax assets and liabilities are recognized based on the estimated future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases.

Deferred tax assets and liabilities are measured using enacted tax rates for the year in which those temporary differences are expected to be recovered or settled. In assessing net deferred tax assets, management considers whether it is more likely than not that some or all of the deferred tax assets will not be realized. When the Company does not believe realization of a deferred tax asset is more likely than not, the Company records a valuation allowance. The valuation allowance is evaluated at the end of each year, considering positive and negative evidence about whether the deferred tax assets will be realized.

The Company is subject to income taxes in the U.S. and certain foreign jurisdictions. Significant judgment is required in evaluating the Company's uncertain tax positions in determining its provision for income taxes. Accounting for income tax uncertainties requires a two-step approach to recognize and measure uncertain tax positions.

The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon settlement.

The Company adjusts the valuation allowance in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions as well as related interest and penalties.

Stock-based compensation

The Company measures and recognizes compensation expense related to stock-based transactions, including employee and director equity awards, in the financial statements based on estimated fair value on the grant date.

The Company uses the Black-Scholes option pricing model to calculate the grant date fair value of share options and deferred share awards, using various assumptions. The Company recognizes compensation expense on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of four years. The compensation expense is net of forfeitures that are estimated using historical trends.

Foreign currency translation

The Company translates the assets and liabilities of its non-U.S. dollar functional currency subsidiaries into U.S. dollars using exchange rates in effect at the end of each period. Revenue and expenses for these subsidiaries are translated using rates that approximate those in effect during the period. Gains and losses resulting from translation are recorded as a component of accumulated other comprehensive loss on the consolidated balance sheet. Gains and losses from foreign currency transactions resulting from the settlement of such transactions are recorded in the consolidated statement of operations.

Fair value measurements of financial instruments

Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which the Company would transact business and considers assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions, and risk of nonperformance.

The Company's valuation techniques are based on maximizing observable inputs and minimizing the use of unobservable inputs when measuring fair value. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect the Company's market assumptions. The inputs are then classified into the following hierarchy:

- Level 1 Inputs—quoted prices in active markets for identical assets and liabilities;
- Level 2 Inputs—observable market-based inputs other than Level 1 Inputs, such as quoted prices for similar assets or liabilities in active markets, quoted prices for similar or identical assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data;
- Level 3 Inputs—unobservable inputs and typically reflect management's best estimate of assumptions that market participants would use in pricing the asset or liability.

The Company's financial assets and liabilities consist principally of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities which are stated at cost, which approximates fair value due to their expected short maturities. As of December 31, 2012, the Company had readily-marketable securities that are classified as cash equivalents of \$0.1 million but this account was closed in 2013. The Company's money market fund valuations were classified within Level 1 of the fair value hierarchy because they are made using prices in active markets for identical assets.

The Company's long term debt bears interest at fixed rates which approximate the interest rates at which the Company believes it could refinance the debt. Accordingly, the carrying amount of long-term debt as of December 31, 2013 approximates its fair value. The fair value of the Company's long term debt was measured within Level 2 of the fair value hierarchy as the interest rate on the long term debt approximates what the Company believes it could get for similar financing terms at the end 2013.

The Company records liabilities for contingent considerations and warrants in conjunction with certain debt and equity financings that are re-measured using Level 3 inputs each year. The Company also records liabilities for contingent considerations resulting from a business combinations at its fair value on the acquisition date, and for each subsequent reporting period revalues these obligations and records increases or decreases in their fair value as an adjustment to operating earnings in the consolidated statements of operations. The Company used Level 3 inputs to assess the fair value of the liabilities using assumptions that include a significant amount of judgment and any changes in the assumptions could have a material impact on the amount of expense recorded in any given period for changes in the value of the liabilities.

Comprehensive income (loss)

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive loss, which consists of the effect of foreign currency translation.

Research and development

The Company expenses research and development costs as they are incurred.

Advertising

Costs associated with advertising are expensed as incurred. Advertising expenses were approximately \$1.3 and \$1.0 million for the years ended December 31, 2013 and 2012, respectively.

Recent accounting pronouncements adopted

As of December 31, 2013, the Company has adopted Accounting Standards Update ("ASU") No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The new standard requires that an unrecognized tax benefit be presented as a reduction of a deferred tax asset for a NOLs or other tax credit carryforward when settlement in this manner is available under the tax law. Unrecognized tax benefits will be netted against all available same jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by the unrecognized tax benefits. The adoption of ASU 2013-11 did not have a material impact on the Company's consolidated balance sheets or statements of operations.

Note 3 – Property and equipment

Property and equipment consisted of the following as of December 31, (in thousands):

	2013	2012
Computer software	\$ 20,592	\$ 17,675
Computer equipment	10,846	10,117
Furniture and fixtures	2,005	1,970
Leasehold improvements	152	154
Work in progress	1,872	2,866
Total property and equipment	35,467	32,782
Less accumulated depreciation	(32,058)	(25,748)
Property and equipment, net	\$ 3,409	\$ 7,034

Depreciation expense for the years ended December 31, 2013 and 2012 was approximately \$5.8 million and \$4.8 million, respectively. In 2013, the Company reevaluated the useful life of this push messaging platform acquired from Mashmobile in 2010 such that it shortened the remaining useful life from 5 years to 1 year, resulting in a fully amortized asset at December 31, 2013. The reevaluation was the result of uncertainty surrounding the future use of these assets in generating revenues.

In 2012, the Company determined the useful life of its existing billing system should be shortened as a new billing system was expected to be put in service in 2013, and accordingly \$0.2 million was recorded for accelerated depreciation on its existing billing system in 2012. As of December 31, 2013, capitalized software costs of \$1.3 million related to the Company's new billing system was included in work in progress as the system is expected to go live in 2014.

Note 4 - Intangible assets and goodwill

The Company carried goodwill of \$7.0 million at both December 31, 2013 and 2012.

The Company's definite-lived intangible assets amortized in 2013 and 2012 consisted of those assets acquired in the acquisition of Mashmobile. Other intangible assets from acquisitions in prior years were fully amortized before 2012. Amortization expense was \$3.4 and \$1.1 million in 2013 and 2012, respectively. In 2013, the Company reevaluated the useful life of this push messaging platform acquired from Mashmobile in 2010 such that it shortened the remaining useful life resulting in \$1.7 million of accelerated amortization expense. The reevaluation was the result of uncertainty surrounding the future use of these assets in generating revenues. Intangible assets consisted of the following (in thousands):

As of December 31, 2013				
	Useful life at Acquisition Date	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	4.25 years	\$ 3,690	\$ (3,690)	\$ --
In process technology	2.25 years	1,800	(1,800)	--
Customer contracts	2.75 years	56	(56)	--
		<u>\$ 5,546</u>	<u>\$ (5,546)</u>	<u>\$ --</u>

As of December 31, 2012				
	Useful life at Acquisition Date	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	4.25 years	\$ 3,690	\$ (1,953)	\$ 1,737
In process technology	2.25 years	1,800	(200)	1,600
Customer contracts	2.75 years	56	(46)	10
		<u>\$ 5,546</u>	<u>\$ (2,199)</u>	<u>\$ 3,347</u>

Note 5 - Income taxes

For financial reporting purposes, loss before income taxes included the following components for the years ended December 31 (in thousands):

	2013	2012
Domestic	\$ 4,591	\$ 6,624
Foreign	(10,980)	(21,759)
	<u>\$ (6,389)</u>	<u>\$ (15,135)</u>

The benefit for income taxes consisted of the following for the years ended December 31 (in thousands):

	2013	2012
Current:		
Federal	\$ 70	\$ 76
State	17	(2)
Foreign	(181)	(124)
Total current	<u>\$ (94)</u>	<u>\$ (50)</u>
Deferred:		
Federal	\$ (9,905)	\$ --
State	--	--
Foreign	--	--
Total deferred	<u>(9,905)</u>	<u>--</u>
Income tax benefit	<u>\$ (9,999)</u>	<u>\$ (50)</u>

A reconciliation of the income tax benefit to the amount computed by applying the statutory federal income tax rate to the loss before income taxes consisted of the following for the years ended December 31 (in thousands):

	2013	2012
Income tax benefit at federal statutory rate of 35%	\$ (2,236)	\$ (5,298)
State income tax expense, net of federal benefit	(67)	(256)
Taxes on foreign losses which differ from the U.S. statutory rate	3,703	7,630
Change in valuation allowance	(11,355)	(2,095)
Other permanent items	<u>(44)</u>	<u>(31)</u>
Income tax benefit	<u>\$ (9,999)</u>	<u>\$ (50)</u>

Tax benefits in 2013 were primarily related to the release of the valuation allowance on deferred tax assets in the U.S. Significant components of the Company's deferred taxes were as follows for the years ended December 31 (in thousands):

	2013	2012
Deferred tax assets:		
Federal and state net operating losses	\$ 12,481	\$ 14,753
Foreign net operating losses	11,833	12,996
Credits	168	75
Accrued expenses	595	2,446
Capitalized research and development	19	37
	<u>25,096</u>	<u>30,307</u>
Valuation allowance	<u>(13,109)</u>	<u>(27,475)</u>
Total deferred tax assets	<u>11,987</u>	<u>2,832</u>
Deferred tax liabilities:		
Unrealized foreign exchange losses	(1,580)	(1,593)
Non-goodwill intangibles	(383)	(731)
Depreciation and amortization	(119)	-
Total deferred tax liabilities	<u>(2,082)</u>	<u>(2,234)</u>
Net deferred tax assets	<u>\$ 9,905</u>	<u>\$ 508</u>
Deferred tax assets included in current assets	\$ 1,620	\$ 121
Deferred tax assets included in non-current assets	8,285	387

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Due to historical taxable losses outside of the U.S. and uncertainties as to future profitability, the Company recorded a full valuation allowance on the deferred tax asset balances as of December 31, 2012. Due to profitability in the U.S. in recent years and the forecast for future years, the Company has reassessed the need for a valuation allowance as of December 31, 2013. The Company determined that it is more likely than not that all of the deferred tax assets in the U.S. will be realized. As a result, a portion of valuation allowance in the U.S. was released in fiscal 2013 resulting in a tax benefit of \$9.9 million. The net change in the total valuation allowance for the years ended December 31, 2013 and December 31, 2012 was an decrease of \$14.4 million and an increase \$2.2 million, respectively.

As of December 31, 2013, the Company had net operating loss carryforwards for federal, state, and foreign income tax purposes of approximately \$33.1 million, \$24.1 million, and \$54.1 million which begin to expire in 2022, 2014, and 2025, respectively. As of December 31, 2013, the Company had research and development credit for the U.S. and for the state of California of approximately \$0.2 and \$0.5 million, which expire beginning in 2029 and carry indefinitely, respectively.

The Company believes it has had multiple ownership changes as defined by Section 382 of the Internal Revenue Code (IRC), due to stock transactions in previous years that may significantly limit the future realization of its net operating loss carry forwards. Based on estimates prepared to date, the Company believes Section 382 could result in the forfeiture of a portion of net operating loss carry forwards for federal income tax purposes and, accordingly, net operating losses or NOLs above have been reduced for these items before the release of the U.S. deferred tax valuation allowance in December 2013.

As of December 31, 2013, the Company had gross unrecognized tax benefits of approximately \$1.9 million, of which \$0.4 million would impact the effective tax rate if recognized. As of December 31, 2012, the Company had gross unrecognized tax benefits of approximately \$1.9 million, of which \$1.2 million would impact the effective tax rate if recognized. A reconciliation of the beginning and ending amounts of unrecognized income tax benefits is as follows for the years ended December 31 (in thousands):

	2013	2012
Balance at beginning of year	\$ 1,890	\$ 1,956
Additions based on tax positions taken during a prior period	57	23
Additions based on tax positions taken during the current period	68	9
Decreases related to lapsing of statute of limitations	(141)	(98)
Balance at end of year	<u>\$ 1,874</u>	<u>\$ 1,890</u>

While it is often difficult to predict the final outcome of any particular uncertain tax position, management does not believe that it is reasonably possible that the estimates of unrecognized tax benefits will change significantly in the next twelve months.

The Company recognizes interest accrued and penalties related to unrecognized tax benefits in its income tax provision. For the years ended December 31, 2013 and 2012, the Company recorded interest of \$0.2 million, in income tax expense.

The Company files corporate income tax returns in the U.S. federal jurisdiction, as well as various states and international jurisdictions, including Australia, France, Germany, Singapore, Spain, and the U.K. For U.S. federal, U.S. state and foreign tax returns, the Company is generally no longer subject to tax examinations for years prior to fiscal 1999, 2000 and 2004, respectively. The federal and state taxing authorities may choose to audit tax returns for tax years beyond the statute of limitation period due to significant tax attribute carry forwards from prior years, making adjustments only to carry forward attributes.

On its 2011 tax provision, the Company presented the unrecognized tax benefits related to the 2010 worthless stock deduction of \$1.4 million as a “gross” presentation. This resulted in approximately \$0.5 million deferred tax asset being recognized with a corresponding liability on the balance sheet. In 2013, the Company adopted ASU 2013-11 guidance and netted such unrecognized tax benefits on worthless stock deduction against its deferred tax asset.

Note 6 – Borrowings

The Company’s debt obligations for revolving line of credits and loans payable consisted of the following for the years ended December 31 (in thousands):

	2013	2012
Balance at beginning of year	\$14,450	\$ 16,555
Advances	17,000	--
Effect of changes in foreign exchange rates	--	269
Repayments	(14,450)	(2,374)
Balance at end of year	<u>\$ 17,000</u>	<u>\$ 14,450</u>

Per the terms of the Company’s debt agreements, the Company expects to repay \$9.7 and \$7.3 million of the debt obligations in 2015 and 2016, respectively.

Secured revolving line of credit

The Company had a revolving line of credit agreement with a maximum credit line of \$17.0 million, inclusive of a \$10.0 million equivalent line available to its U.K. subsidiary. Advances were subject to a borrowing base calculated using accounts receivable. Repayment of the principal amounts was due upon maturity of the revolving line of credit in May 2012. In May 2012, the Company amended the line of credit requiring certain quarterly principal payments and decreasing the maximum credit line at maturity to \$16.3 million including a commitment fee of \$0.1 million paid in June 2012. The line was collateralized by all of the Company's assets.

The revolving credit agreement required the Company to maintain liquidity above certain asset-based thresholds, meet certain financial ratios and monthly reporting requirements. Additionally, the loan included a default provision in which the bank may call the debt in the event of a material adverse change within the Company. The Company received a waiver from the bank for non-compliance with the EBITDA covenant in December 2012.

In February 2013, the Company entered into a new revolving line of credit agreement another bank with a maximum credit line of \$8.0 million. Advances are subject to a borrowing base calculated using the bank's eligibility definitions. Of the \$8.0 million, no more than \$4.0 million may be advanced on eligible accounts receivable from its U.K. subsidiary, of which no more than \$2.0 million may be due from debtors from the U.K. subsidiaries' non-U.K. customers in Europe. Repayment of the principal amount is due upon maturity of the revolving line of credit in February 2015. Interest is paid on a monthly basis on the loan and accrues at a rate of 4.75% as of December 2013 (1.50% plus the bank's prime rate). During 2013, the Company took cash advances of \$3.0 million and issued letter of credits of \$0.3 million relating to collateral deposits for office lease agreements. There were no amounts outstanding against the letter of credits as of December 31, 2013. The unused line of credit as December 31, 2013 was \$4.7 million.

The revolving credit agreement required the Company to maintain liquidity above certain asset-based thresholds and monthly reporting requirements. The Company was in compliance with all of the bank's covenants as of December 31, 2013.

In connection with the new line of credit agreement, the Company paid loan and legal fees of \$0.1 million that is amortized in interest expense over the term of credit facility. Additionally, the Company issued warrants for 257,235 shares of Series F Preferred Stock at an exercise price of \$0.311 per share. The warrants have a term of ten years and survive the termination of the credit facility.

Subordinated loan

In February 2013, the Company entered into subordinated loan agreement totaling \$14.0 million. The Company will make interest only payments in the first two years of the agreement. Starting in April 2015, the Company will begin repaying the principal equally over the final 18 months until it matures in September 2016. Interest is paid on a monthly basis at an annual rate of 10.75% for the entire 42-month term of the subordinated loan agreement. The subordinated loan agreement requires the Company to maintain standard rate message revenue (excluding PSMS) on a trailing twelve month basis of at least \$80.0 million. The bank agreement's covenants require certain monthly financial reporting. The Company was in compliance with the subordinated loan agreement's covenants as of December 31, 2013.

In connection with the loan, the Company paid loan and legal fees of \$0.3 million and will pay a deferred closing fee of \$0.6 million upon the earlier of the final payment, full payment of the loan or acceleration of the date of the loan due to default and was fully recorded as deferred costs in 2013. The total of these costs are amortized straight-line over the 42-month period of the loan.

The Company could potentially make an additional payment ("Success Fee") based on the exit value calculated upon the initial public offering or liquidity event (sale of at least more than 50% of the Company's stock). The Success Fee survives any termination of the agreement and expires in February 2023 and will be recorded if an exit event occurs.

Exit Value	Success Fee (000's)
Less than \$150 million	\$ --
Equal to or greater than \$150 million but less than \$250 million	750
Equal to or greater than \$250 million but less than \$350 million	1,500
Equal to or greater than \$350 million	2,500

In connection with the loan agreement, the Company also issued warrants for a total of 3,826,366 shares of Series F Preferred Stock at an exercise price of \$0.311 per share. The warrants have a term of ten years from the February 2013 subordinated loan agreement date and survive the termination of the loan agreement. In the event the Company issues preferred stock in a financing on or prior to March 31, 2014, then at the warrant holders election the Company will grant to the warrant holder the right to subscribe and purchase from the Company additional preferred shares of the same class and series of the Company's voting preferred shares. The Company did not have a round financing from February 28, 2013 through March 31, 2014 so the additional shares purchase option expired on April 1, 2014 with no shares issued.

Note 7 - Commitments and contingencies

Lease arrangements

The Company leases office space, data center facilities and equipment under non-cancelable operating leases with various expiration dates through 2019. These leases require the Company to pay operating costs, including property taxes, insurance and maintenance. The facility leases generally contain renewal options and provisions adjusting the lease payments, either based upon changes in the consumer price index or in fixed increments. Rent expense is recorded on a straight-line basis over the respective terms of the lease. Rent expense amounted to approximately \$2.0 million in both 2013 and 2012. Future minimum lease payments under non-cancelable operating leases as of December 31, 2013, were as follows (in thousands):

2014	\$ 2,314
2015	1,207
2016	542
2017	403
2018	416
Thereafter	249
Total	<u>\$ 5,131</u>

Note 8 - Litigation and other legal matters

While the outcome of some of the following matters is currently not determinable, the Company believes it has meritorious defenses and intends to defend itself vigorously. Except as otherwise noted, all of the following claims against the Company, whether meritorious or not, could result in costly litigation, require amounts of management time, and result in the diversion of operational resources. If an unfavorable outcome occurs, it could have a material adverse impact on the Company's consolidated financial position and results of operations for the period in which the unfavorable outcome occurs or becomes probable and reasonably estimable.

Litigation

Paluzzi v. mBlox - In December 2007, a complaint alleging unauthorized premium content charges was filed in Chicago, Cook County Circuit Court. The Court granted preliminary approval to a class-action settlement agreement on September 10, 2009 and on January 10, 2010, the Court granted final approval and the case was dismissed with prejudice. In addition, pursuant to the terms of the Paluzzi national class-action settlement discussed above, each of the related cases brought against the Company prior to the Paluzzi class certification and which were stayed pending the Paluzzi proceedings were dismissed with prejudice. Pursuant to the terms of its contracts, the Company must indemnify certain mobile carriers for legal fees incurred in Paluzzi and related cases. During the year ended December 31, 2009, the Company accrued \$2.5 million for fees, costs and expenses incurred by mobile carriers joined in Paluzzi and the related cases, net of amounts receivable from the Company's customers whose traffic was alleged to have given rise to the action. As of December 31, 2013, the Company had \$0.8 million recorded for payables to the mobile carriers and was included in other accrued liabilities on the consolidated balance sheet.

Cellfish v. mBlox - In October 2011, the Company's customer Cellfish Media, LLC ("Cellfish") filed a complaint alleging breach of contract in Santa Clara Superior Court. Cellfish alleged that the Company breached its Master Services Agreement with Cellfish by failing to timely remit sums that the Company acknowledged were otherwise due and owing to Cellfish. In its November 2011 answer to the complaint, the Company claimed that it legitimately withheld such sum as payment for a total of \$1.5 million for numerous unpaid invoices. The Company also filed a counter-claim against Cellfish for money damages, attorney fees and declaratory relief. The invoices related to third-party costs incurred by the Company in relation to the Paluzzi matter (described above) and the related cases, in which Cellfish and other mBlox customers were alleged to have engaged in a scheme to charge mobile phone users for unauthorized premium message content that was never requested by the user. Following its complaint, Cellfish sought a writ of attachment, which the court denied on December 13, 2011. The parties settled this matter in July 2013 in exchange for payment by the Company of \$0.5 million.

Dotted Line v. mBlox - In September 2012, the Company's customer Dotted Line Media Inc. ("Dotted Line") filed for arbitration, alleging breach of contract on the part of the Company by failing to timely remit sums due to Dotted Line. The Company contended (i) it was holding these amounts in accordance with the agreement, (ii) such amounts were being withheld due to the fact that AT&T wireless found unauthorized transactions by Dotted Line and had initiated an audit of all PSMS-related transactions on the Company's platform going back to January 1, 2010, (iii) it would release the funds to Dotted Line upon carrier sign-off, as it is possible that such funds could be "clawed-back" by AT&T (and other carriers) if the audit revealed further unauthorized billing by Dotted Line. Arbitration was held on April 8, 2013 and on May 7, 2013 the arbitrator ruled that the Company must release to Dotted Line the amount withheld of approximately \$3.3 million, which was appropriately included in Accrued premium rate short message service payments as of December 31, 2012. In addition, the Company paid interest to Dotted Line of \$0.1 million in 2013.

Club Texting, et. al. v. mBlox, et al. - In April 2012, the Company and numerous other aggregators and wireless carriers were served with civil complaints filed in the U.S. District Court for the Southern District of New York - the cases have since been consolidated. The case seeks class action status. The plaintiffs claim that the defendants have violated the Sherman Act through a conspiracy to "favor" short codes (and their associated administrative costs) over long codes. The business models of the plaintiffs are based on the use of long codes. The Company joined other defendants in a motion to dismiss and filed its own motion to compel arbitration, as the Company had an agreement with one of the plaintiffs that contained such a provision. Verizon Wireless has issued an indemnification notice to the Company in connection with this litigation, but claims it is only a "placeholder" notice with no specifics beyond that. Following a hearing in September 2013, the judge issued an order to compel arbitration, forcing the plaintiffs to arbitrate with each defendant separately. The plaintiffs have proceeded with arbitration against the carriers but not the aggregator defendants. The Company cannot currently estimate the probability of a specific outcome. The Company regularly evaluates current information available to determine if an accrual is required.

Fields et al, v. Wise Media, LLC, etc. et al. On March 27, 2013, the Company was served with a civil complaint in an action entitled Fields et al v. Wise Media, et al. This complaint alleged that the Company engaged in a pattern of behavior that violated the Telephone Consumer Protection Act and various other California state statutes. The complaint also requested the court to certify the plaintiffs as a national class. In April 2013, the Company filed summary judgment in response to the complaint setting forth facts that show the Company did not engage in the actions alleged in the complaint. In December 2013, the court denied class certification and granted a portion of the Company's motion for summary judgment. The plaintiffs settled with the Company in exchange for \$18 thousand and dismissed the complaint.

Indemnification claims

In addition, in certain contracts, the Company has agreed to indemnify mobile operators (the "Indemnified Parties") for expenses or liability resulting from claimed charges of third parties asserted against the Indemnified Parties. From time to time, the Company receives requests for indemnity and may choose to assume the defense of such litigation asserted against the Indemnified Parties.

Other matters

From time to time, the Company is engaged in other legal proceedings incidental to its normal business activity. Management regularly evaluates the materiality and probability of loss related to these matters. The Company settled certain matters during 2013 and 2012 that did not individually or in the aggregate have a material impact on the Company's financial condition and results of operations.

Note 9 - Employee benefit plan

The Company has a 401(k) plan to provide defined contribution retirement benefits for all U.S. employees. Participants may contribute a portion of their compensation to the Plan, subject to the limitations under the Internal Revenue Code. The Company's match contribution to the Plan is at the discretion of the Board of Directors. The Company accrued contributions to the 401(k) plan of \$0.1 million for the years ending 2013 and 2012.

The Company has a defined contribution plans to provide retirement benefits for employees in countries outside of the U.S. Participants may contribute a portion of their compensation to the plan and the Company provides a matching contribution up to certain limits in each country of the participant's gross salary. The Company contributed \$0.6 million for both 2013 and 2012 to defined contribution plans for employees outside of the U.S.

Note 10 - Restructuring

In September 2012, the Company implemented a sharpened strategy to focus on business-to-consumer messaging and cease development of new mobile payments products. New mobile payment product and technology initiatives were terminated including development of a new payments-oriented operating platform. The existing PSMS product and customers would be sunset and no new customers would be accepted. A total of 39 employees were terminated. In connection with this restructuring, the Company recorded a \$12.4 million restructuring charge in 2012. During the first quarter of 2013, the Company implemented a revised organization structure in connection with the exiting of the PSMS business resulting in the termination of an additional 60 employees and recorded severance costs of \$2.6 million. The restructuring activities consisted of the following for the years ended December 31 (in thousands):

	2013	2012
Balance at beginning of year	\$ 690	\$ --
Expense for new restructuring activities	2,562	12,369
Expense for changes in prior years estimate	(679)	--
Asset write-offs	--	(11,117)
Payments, net of foreign exchange impact	(2,573)	(562)
Balance at end of year	\$ --	\$ 690

Note 11 – Contingent Consideration Liability

On October 6, 2010, mBlox Inc. acquired all of the stock of Mashmobile Sweden AB, a private company based in Sweden. mBlox paid consideration at the time of close of \$4.3 million in cash and \$0.8 million (5,468,000 shares at \$0.14 per share) of mBlox, Inc. common stock at closing.

The sellers of Mashmobile were eligible for contingent consideration up to an additional 13,905,066 shares of mBlox, Inc. common stock and could be earned over a three-year period ending December 31, 2013, through a certain level of activations. In addition, if the Company had completed an initial public offering or was acquired prior to December 31, 2013, all shares would have been earned. During 2013 and 2012, the sellers of Mashmobile earned 587,419 and 126,810 of such shares, respectively, based on download activity. The earned shares for 2012 were issued in February 2013 and the 2013 earned shares are expected to be issued in May 2014. The fair value for contingent consideration as of December 31, 2013 and 2012 was determined based on Level 3 inputs utilizing unobservable inputs for which there is little, if any, market activity. The inputs are based on the levels of qualifying activations, discount rate, and probability of achieving defined milestones. For the years ended December 31, 2013 and 2012, fair value adjustments from the reduction of the Company's contingent consideration liability resulted in gains recorded in general and administrative expense of \$0.6 and \$1.6 million, respectively. The fair value for the contingent consideration was as of December 31 (in thousands):

	Fair Value	Inputs Level 1	Inputs Level 2	Inputs Level 3
Liabilities (in thousands)				
December 31, 2013	\$ 53	\$ --	\$ --	\$ 53
December 31, 2012	\$ 638	\$ --	\$ --	\$ 638

Note 12 - Sale of PSMS customer contracts

In March 2013, the Company sold to OpenMarket the customer contracts and related commitments for the PSMS product line in the U.S., U.K., Australia and Ireland, representing nearly all of the Company's PSMS product line. As part of the transaction, customers will be directed to OpenMarket for continued support of PSMS products and customer contracts will be assigned to OpenMarket. In return, the Company will receive a royalty from OpenMarket calculated as a percentage of the gross profit generated by the customer contracts. The royalty percentage starts at 35% in the first quarter of the arrangement and decreases over the course of the 18-month agreement until reaching 15% in the final quarter ending September 2014. The royalty payment will be made monthly by OpenMarket 75 days after the month end.

Note 13 - Stockholders' equity

The Company had the following shares outstanding and shares reserved for issuance as of December 31, 2013 (in thousands):

	Authorized	Outstanding
<u>Common Stock</u>		
Class 1	694,000	176,715
Class 2	75,000	5,954
<u>Preferred Stock - Voting</u>		
Series A-1	5,405	2,667
Series A-2	94,998	26,192
Series B	2,472	2,472
Series C-1	64,361	31,040
Series D-1	81,139	58,549
Series E-1	51,790	39,732
Series F	<u>108,374</u>	<u>56,763</u>
	408,539	217,415
<u>Preferred Stock – Non-voting</u>		
Series A-11	1,369	1,369
Series A-22	24,804	24,804
Series C-11	10,668	10,668
Series D-11	11,295	11,295
Series E-11	5,817	5,817
Series FF	<u>15,374</u>	<u>11,870</u>
	69,327	65,823
<u>Reserved for Issuance</u>		
Preferred stock warrants		14,167
Common stock options outstanding		57,698
Common stock options available for future grants under stock option plans		8,006

Preferred stock

In 2012, the Company and its shareholders approved a program whereby certain shareholders exchanged all their shares of preferred and common stock for new series of non-voting preferred and common stock. Participating holders exchanged 1,369,326, 24,803,530, 10,668,236, 11,295,448, 5,817,134 and 11,869,961 shares of Series A-1, A-2, C-1, D-1, E-1 and F preferred stock, respectively for the same number of share of Series A-11, A-22, C-11, D-11, E-11 and FF preferred stock. Participating holders also exchanged 5,954,133 shares of Common Stock Class 1 for the same number of shares of Common Stock Class 2. It was determined there was no change in value because the only difference was voting rights.

Series A-2, A-22, C-1, C-11, D-1, D-11, E-1, E-11, F and FF have similar rights, preferences and privileges, and are collectively referred to as senior preferred stock. Series A-1, A-11 and B also have similar rights, preferences and privileges, and are collectively referred to as junior preferred stock. Series A-1, A-2, B, C-1, D-1, E-1 and F are referred to as voting preferred stock. Series A-11, A-22, C-11, D-11, E-11 and FF are referred to as non-voting preferred stock. The significant terms of the Series A-1, A-11, A-2, A-22, B, C-1, C-11, D-1, D-11, E-1, E-11, F and FF preferred stock are as follows:

- a. Holders of Series A-1, A-11, A-2, A-22, B, C-1, C-11, D-1, D-11, E-1, E-11, F and FF preferred stock are entitled to noncumulative dividends of \$0.009 for Series A-2 and A-22 preferred stock, \$0.017 for Series C-1 and C-11 preferred stock, \$0.028 for Series D-1 and D-11 preferred stock, \$0.039 for Series E-1 and E-11 preferred stock, and \$0.025 for Series F and FF preferred stock, if and when declared by the Company's Board of Directors. Series A-1, A-11 and B do not have a stated dividend rate. In addition, if any dividend is paid on any junior stock, the holders of senior preferred stock are entitled to receive an equal amount per share (on an as-if-converted-to-common-stock basis) to the amount paid or set aside for each share of junior stock. No dividends have been declared through December 31, 2013.
- b. In the event of a liquidation, dissolution, or winding-up of the Company, either voluntarily or involuntary, stockholders are entitled to distribution preferences as follows: Series F and FF receives distributions at \$0.311 per share, Series E-1 and E-11 receives distributions of \$0.483 per share, Series A-2 and A-22 receives distributions at \$0.173 per share, Series C-1 and C-11 receives distributions at \$0.210 per share, Series D-1 and D-11 receives distributions at \$0.353 per share, Series A-1 and A-11 receives distributions at \$1.000 per share, and Series B receives distributions of \$0.160 per share.

Before any distribution or payment shall be made to the holders of Series A-1, A-11, A-2, A-22, C-1, C-11, D-1 or D-11 preferred stock and any junior preferred stock, the holders of Series F, FF, E-1 and E-11 preferred stock shall be entitled to be paid out of the assets of the Company legally available for distribution, plus all declared and unpaid dividends. If the assets of the Company, or consideration received, are insufficient to make payment in full to all of the holders of Series F, FF, E-1 and E-11 preferred stock, then such assets (or such consideration received in such transaction) shall be distributed among the holders of Series F, FF, E-1 and E-11 preferred stock ratably in proportion to the amounts that they would have otherwise received.

Upon distribution to Series F, FF, E-1 and E-11, Series A-2, A-22, C-1, C-11, D-1 and D-11 have priority in distributions. Upon distribution to Series A-2, A-22, C-1, C-11, D-1 and D-11, Series A-1 and A-11 has priority in distributions. Upon distribution to Series A-1 and A-11, Series B is next in distribution priority. The remainder of the assets shall be distributed ratably to holders of common stock and Series A-2, A-22, C-1, C-11, D-1, D-11, E-1, E-11, F and FF preferred stock on an as-if-converted-to-common-stock basis; however, the holders of Series C-1, C-11, D-1, D-11, E-1, E-11, F and FF will have maximum distributions equal to \$19.6 million, \$6.7 million, \$62.0 million, \$12.0 million, \$57.6 million, \$8.4 million, \$53.0 million, and \$11.1 million respectively.

- c. Each share of Series A-2, B, C-1, D-1, E-1, and F preferred stock is convertible into one share of class 1 common stock of the Company at the option of the holder. Each share of Series A-22, C-11, D-11, E-11, and FF preferred stock is convertible into one share of class 2 common stock of the Company at the option of the holder. The conversion rate is subject to adjustment in the event of, among other things, stock splits and stock dividends. Each Series A-1 and A-11 share converts to one share of class 1 and 2 common stock, respectively in the event the majority of the holders of Series A-2, B, C-1, D-1, E-1, and F preferred stock, voting as a single class, elect to convert to common stock.

The conversion rate is subject to adjustment in the event of, amongst other things, stock splits and stock dividends. All shares of preferred stock will automatically convert to common stock immediately upon the closing of a public offering resulting in gross proceeds to the Company of at least \$25.0 million.

- d. A majority of the holders of Series A-2, C-1, D-1, E-1, and F preferred stock, voting together as a single class, is required for approval of significant transactions, such as changes to equity structure, payment of dividends or other distributions, change in the size of the Board of Directors, and acquisition or dissolution of the Company. A majority of holders of Series B preferred stock, voting as a class, is required for approval of any change in corporate or equity structure that would affect their shares. Series A-1 preferred stock is non-voting.
- e. There are no redemption rights for the preferred stock holders.

Warrants

In 2013, the Company had outstanding equity classified common stock warrants of 4,596,299 that expired unexercised related to the Company's purchase of its U.K. subsidiary that were issued in 2003.

The Company had the following outstanding warrants for the issuance of preferred stock as of December 31 (in thousands, except for share price):

Type	Expiration date	Exercise price per share	Number of shares 2013	Number of shares 2012	Fair value 2013	Fair value 2012
Series F	Sept. 2014	\$ 0.311	4,243	4,243	\$ 3	\$ 48
Series F	Sept. 2015	\$ 0.010	2,337	2,337	678	944
Series F	Feb. 2023	\$ 0.311	4,084	--	304	--
Series FF	Sept. 2014	\$ 0.311	2,053	2,053	1	23
Series FF	Sept. 2015	\$ 0.010	1,450	1,450	421	586
					<u>\$ 1,407</u>	<u>\$ 1,601</u>

A roll forward of the fair value of the preferred stock warrant liability is as follows as of December 31 (in thousands):

	2013	2012
Balance at beginning of year	\$ 1,601	\$ 1,719
Additional warrants	236	--
Change in fair value recorded	(430)	(118)
Balance at end of year	<u>\$ 1,407</u>	<u>\$ 1,601</u>

In May 2012, the Company exchanged 2,053,146 of preferred stock Series F warrants with an exercise price of \$0.311 and 1,450,510 of preferred stock Series F warrants with an exercise price of \$0.010 for the same number of Series FF warrants with the same terms except the Series FF warrants do not have voting rights. The Series FF warrants were determined to have the same fair value as Series F because the only difference was voting rights. In February 2013, the Company issued 4,083,601 of preferred stock series F warrants with an exercise price of \$0.311 in connection with new debt agreements.

The estimated fair value of the warrant liabilities recorded was calculated using an option pricing model with the following assumptions and fair values:

	2013	2012
Fair value of stock	\$0.120 - \$0.380	\$0.17 - \$0.400
Exercise price	\$0.01 - \$0.311	\$0.01 - \$0.311
Risk-free interest rate	0.12% - 3.04%	0.24% - 0.35%
Contractual term	0.7 - 10.0 years	1.8 - 2.8 years
Dividend	--	--
Volatility	10% - 65%	45%

Note 14 - Equity awards

Stock option plan

In 2013, the Company granted options to purchase shares of its common stock pursuant to the terms of its 2003 and 2013 equity incentive plans. A total of 65,704,125 shares were reserved for issuance under the 2013 Plan as of December 31, 2013. The 2003 plan was closed to additional grants in September 2013. The Company grants options to purchase shares of its common stock pursuant to the terms of its 2013 Equity Incentive Plan (the “2013 Plan”), which was adopted by the Board of Directors on August 28, 2013. Under the 2013 Plan, the exercise price of an option cannot be less than the fair market value of one share of common stock on the date of grant for incentive stock options or 85% of the fair market value of one share of common stock for non-statutory stock options (not less than 110% of the fair market value for stockholders owning greater than 10% of all classes of stock) as determined by the Board of Directors. Options generally expire after 10 years (5 years for stockholders owning greater than 10% of all classes of stock) and vest over a 48-month period.

Restricted stock units

The Company also grants restricted stock units (“RSU”) to provide the employee with the right to receive shares of the Company’s common stock subject to employment and performance vesting conditions. These RSUs vest over a 48-month period beginning upon a liquidity event and are settled upon vesting. The RSUs were all cancelled in 2012 and we had no outstanding RSUs as of December 31, 2013 and 2012.

Outstanding stock option awards

The information about stock options outstanding as of December 31, 2013:

Exercise price per share	Options Outstanding			Options exercisable	
	Number Outstanding (000s)	Remaining Contractual Life (in years)	Weighted average exercise price	Number Exercisable (000s)	Weighted average exercise price
\$0.015 – 0.015	2,662	0.43	\$0.015	2,662	\$0.015
0.070 – 0.070	54,002	8.48	0.070	10,936	0.070
0.100 – 0.140	180	4.99	0.130	175	0.130
0.170 – 0.170	85	7.62	0.170	48	0.170
0.180 – 0.180	2	0.26	0.180	1	0.180
0.210 – 0.210	37	3.67	0.210	29	0.210
0.260 – 0.260	135	3.33	0.260	135	0.260
0.410 – 0.410	276	3.66	0.410	276	0.410
0.420 – 0.420	281	4.22	0.420	281	0.420
0.440 – 0.440	38	3.60	0.440	38	0.440
\$0.015 – 0.440	<u>57,698</u>	8.04	\$0.072	<u>14,581</u>	\$0.077

The total intrinsic value of options exercised during the years ended December 31, 2013 and 2012, was less than \$0.1 million in both years. Stock option activity under all plans were as follows (share amounts in thousands):

	Number of options outstanding	Weighted average exercise price
Outstanding, December 31, 2011	39,948	\$ 0.173
Granted	9,592	0.181
Forfeited or expired	(15,704)	0.161
Exercised	<u>(219)</u>	0.046
Outstanding, December 31, 2012	33,617	\$ 0.182
Granted	55,279	0.070
Forfeited or expired	(30,910)	0.189
Exercised	<u>(288)</u>	0.015
Outstanding, December 31, 2013	<u>57,698</u>	\$ 0.072
As of December 31, 2013:		
Options expected to vest	45,572	
Options exercisable	14,581	

The non-vested stock option activity under all plans were as follows (share amounts in thousands):

	Number of options outstanding	Weighted average exercise price
Outstanding, December 31, 2011	16,527	\$ 0.169
Granted	9,592	0.181
Forfeited or expired	(5,034)	0.149
Vested	<u>(5,318)</u>	0.172
Outstanding, December 31, 2012	15,767	\$ 0.179
Granted	55,279	0.070
Forfeited or expired	(16,935)	0.166
Vested	<u>(10,994)</u>	0.071
Outstanding, December 31, 2013	<u>43,117</u>	\$ 0.070

Note 15 - Stock-based compensation

The fair value of each grant of stock options was determined by the Company and its Board of Directors using the Black-Scholes option pricing model and assumptions discussed below.

Expected term. The expected term represents the period that the Company's stock-based awards are expected to be outstanding. For option grants that are considered to be "plain vanilla," the Company used the simplified method to determine the expected term. The simplified method is calculated as the average of the time-to-vesting and the contractual life of the options.

Expected volatility. The expected volatility was based on the historical stock volatilities of several of the Company's publicly listed peers over a period equal to the expected terms of the options as the Company did not have a sufficient trading history to use the volatility of its own common stock.

Risk-free interest rate. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for zero coupon U.S. Treasury notes with maturities approximately equal to the option's expected term.

Expected dividend. The Company has never paid dividends and does not expect to pay dividends in the foreseeable future.

Forfeiture rate. The Company estimates its forfeiture rate based on an analysis of its actual forfeitures and will continue to evaluate the adequacy of the forfeiture rate based on actual forfeiture experience, analysis of employee turnover behavior, and other factors. If the actual number of future forfeitures differs from that estimated by the Company, the Company may be required to record adjustments to stock-based compensation expense in future periods. The Company's estimated forfeiture rate was 20.08% and 17.66% for 2013 and 2012, respectively.

The weighted-average fair value of an option granted in 2013 and 2012, using the Black-Scholes option pricing model, was \$0.03 and \$0.08, respectively. The assumptions used to value stock options granted are as follows for the years ended December 31:

	2013	2012
Risk-free interest rate	1.05% - 1.78%	0.18% - 1.14%
Expected life (in years)	6.1	6.1
Expected dividend	--	--
Volatility	56%	45%

In August 2013, the Company modified certain stock options that were "under water" and changed the exercise price to \$0.07 resulting in an additional \$0.2 million of stock-based compensation expense during the year. The stock-based compensation recognized by functional costs for years ended December 31 (in thousands):

	2013	2012
Cost of revenue operations	\$ 83	\$ 68
Research and development	158	106
Sales and marketing	155	146
General and administrative	337	274
Total	<u>\$ 733</u>	<u>\$ 594</u>

As of December 31, 2013, the total compensation cost related to non-vested awards not yet recognized was approximately \$1.7 million. The weighted-average remaining recognition period for non-vested options as of December 31, 2013 was 3.5 years.

Note 16 - Related-party transactions

The Company had a revolving line of credit with a bank that was terminated in February 2013. One of the members of the bank's Board of Directors was also a member of the Company's Board of Directors while the revolving line of credit was outstanding.

Note 17 - Subsequent events

The Company has evaluated subsequent events for recognition or disclosure through May 14, 2014, the date on which the accompanying consolidated financial statements being presented were available to be issued.