

LENCO MOBILE INC.  
Form 10-Q  
August 19, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2014

or

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

For the transition period from \_\_\_\_\_

Commission File Number: **000-53830**

**LENCO MOBILE INC.**  
(Exact name of registrant  
as specified in its charter)

Delaware

75-3111137

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(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

2025 First Avenue, Suite 320, Seattle, WA 98121  
(Address of principal executive offices) (Zip Code)

(800)-557-4148  
(Registrant's  
telephone  
number,  
including area  
code)

Not Applicable  
(Former name,  
former address  
and former fiscal  
year, if changed  
since last report)

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 ninety (90) days. Yes  No

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

As of August 12, 2014, 82,145,314 shares of Lenco Mobile Inc.'s common stock were outstanding.

**LENCO MOBILE INC.**

**FORM 10-Q**

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**PART I – FINANCIAL INFORMATION****Item 1. Unaudited Financial Statements.****Lenco Mobile Inc.****Condensed Consolidated Balance Sheets**

|  | As of                                |                      |
|--|--------------------------------------|----------------------|
|  | June 30,<br>2014                     | December<br>31, 2013 |
|  | (In thousands, except<br>share data) |                      |
| <b>ASSETS</b>  |                                      |                      |
| Current assets:  |                                      |                      |
| Cash and cash equivalents  | \$426                                | \$513                |
| Accounts receivable, net   | 2,127                                | 2,760                |
| Other current assets   | 144                                  | 249                  |
| Total current assets   | 2,697                                | 3,522                |
| Property and equipment, net  | 150                                  | 209                  |
| Other noncurrent assets:   |                                      |                      |
| Intangible assets - goodwill   | 568                                  | 573                  |
| Intangible assets - other, net   | 2,992                                | 3,152                |
| Other noncurrent assets  | 143                                  | 109                  |
| Total other noncurrent assets  | 3,703                                | 3,834                |
| Total assets   | \$6,550                              | \$7,565              |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                      |                      |
| Current liabilities:   |                                      |                      |
| Accounts payable and accrued expenses  | \$8,188                              | \$7,689              |
| Deferred revenue   | 667                                  | 591                  |
| Retention bonus  | 2,086                                | 1,982                |
| Preferred dividend payable   | 5,431                                | 4,484                |
| Current portion of long-term obligations, (convertible debt portion of \$260, and \$260, respectively) | 13,126                               | 11,579               |
| Liability for reclassified equity contracts  | 1,253                                | 2,514                |
| Total current liabilities  | 30,751                               | 28,839               |
| Long-term obligations, less current portion, net of debt discount (of \$126, and \$503, respectively)  | 1,884                                | 1,520                |
| Total liabilities  | 32,635                               | 30,359               |

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Shareholders' equity:

Preferred Stock, Series A 1,000,000 shares authorized, \$.001 par value, 181,180 and 181,180 shares issued and outstanding at June 30, 2014 and at December 31, 2013, respectively, Liquidation Preference of \$49,389 and \$43,285 at June 30, 2014 and at December 31, 2013, respectively

Preferred Stock, Series A1 1,000,000 shares authorized, \$.001 par value, 17,733 and 17,773 shares issued and outstanding at June 30, 2014 and at December 31, 2013 respectively, Liquidation Preference of \$2,506 and \$2,197 at June 30, 2014 and at December 31, 2013, respectively

Preferred Stock, Series B1 1,000,000 shares authorized, \$.001 par value, 87,717 shares issued and outstanding at June 30, 2014 and at December 31, 2013, respectively, Liquidation Preference of \$9,173 and \$9,038 at June 30, 2014 and at December 31, 2013, respectively

Preferred Stock, Series B2 1,000,000 shares authorized, \$.001 par value, 58,131 shares issued and outstanding at June 30, 2014 and at December 31, 2013, respectively, Liquidation Preference of \$6,079 and \$5,989 at June 30, 2014 and at December 31, 2013, respectively

Common stock, 250,000,000 shares authorized, \$.001 par value, 82,145,314 and 82,145,314 shares issued and outstanding at June 30, 2014 and at December 31, 2013, respectively

|  |           |           |
|--|-----------|-----------|
| Additional paid in capital                   | 81        | 81        |
| Accumulated other comprehensive loss         | 94,713    | 93,600    |
| Accumulated deficit                          | (643 )    | (692 )    |
| Treasury stock, at cost, 1,400,000 shares    | (119,937) | (115,484) |
| Total Lenco Mobile Inc. shareholders' equity | (299 )    | (299 )    |
|  | (26,085 ) | (22,794 ) |

|  |         |         |
|--|---------|---------|
| Total liabilities and shareholders' equity | \$6,550 | \$7,565 |
|--|---------|---------|

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

**Lenco Mobile Inc.****Condensed Consolidated Statements of Operations**

|   | Three Months Ended June<br>30,       |            | Six Months Ended June 30,            |            |
|---|--------------------------------------|------------|--------------------------------------|------------|
|   | 2014                                 | 2013       | 2014                                 | 2013       |
|   | (In thousands, except share<br>data) |            | (In thousands, except share<br>data) |            |
| Revenue   | \$4,243                              | \$4,104    | \$7,873                              | \$7,765    |
| Cost of sales   | 1,911                                | 2,196      | 3,606                                | 3,612      |
| Gross profit  | 2,332                                | 1,908      | 4,267                                | 4,153      |
| Operating expense:  |                                      |            |                                      |            |
| Sales and marketing   | 746                                  | 972        | 1,772                                | 2,203      |
| General and administrative  | 1,590                                | 1,570      | 3,213                                | 3,130      |
| Research and development  | 994                                  | 1,165      | 1,974                                | 1,987      |
| Depreciation and amortization   | 104                                  | 297        | 216                                  | 602        |
| Total operating expense   | 3,434                                | 4,004      | 7,175                                | 7,922      |
| Loss from operations  | (1,102 )                             | (2,096 )   | (2,908 )                             | (3,769 )   |
| Other income (expense):   |                                      |            |                                      |            |
| Interest expense, net   | (865 )                               | (595 )     | (1,962 )                             | (942 )     |
| Other income (expense), net   | (17 )                                | (5 )       | (24 )                                | (7 )       |
| Valuation of reclassified equity contracts                              | 846                                  | 4,868      | 1,261                                | (2,501 )   |
| Total other income (expense)  | (36 )                                | 4,268      | (725 )                               | (3,450 )   |
| Income (loss) from operations before income taxes                       | (1,138 )                             | 2,172      | (3,633 )                             | (7,219 )   |
| Provision for income taxes (benefit)                                    | (35 )                                | (28 )      | (127 )                               | (11 )      |
| Net income (loss) attributable to Lenco Mobile Inc.                     | (1,103 )                             | 2,200      | (3,506 )                             | (7,208 )   |
| Preferred stock dividends   | (480 )                               | (703 )     | (948 )                               | (998 )     |
| Series A Preferred Stock accretion of beneficial conversion feature     | —                                    | —          | —                                    | (14 )      |
| Net income (loss) attributable to common stockholders                   | \$(1,583 )                           | \$1,497    | \$(4,454 )                           | \$(8,220 ) |
| Net loss per share applicable to common stockholders - basic            | \$(0.02 )                            | \$0.02     | \$(0.05 )                            | \$(0.10 )  |
| Net income (loss) per share applicable to common stockholders - diluted | \$(0.02 )                            | \$0.01     | \$(0.05 )                            | \$(0.10 )  |
| Weighted average shares used in per share calculation - basic           | 82,213,654                           | 80,478,648 | 82,213,654                           | 80,478,648 |

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|   |            |             |            |            |
|---|------------|-------------|------------|------------|
| Weighted average shares used in per share calculation - diluted | 82,213,654 | 151,421,864 | 82,213,654 | 80,478,648 |
|---|------------|-------------|------------|------------|

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

**Lenco Mobile Inc.**

**Condensed Statements of Comprehensive (Loss)**

|   | Three Months   |         | Six Months     |           |
|---|----------------|---------|----------------|-----------|
|   | Ended June 30, |         | Ended June 30, |           |
|   | 2014           | 2013    | 2014           | 2013      |
|   | (In thousands) |         | (In thousands) |           |
| Net income (loss)                       | \$(1,103)      | \$2,200 | \$(3,506)      | \$(7,208) |
| Foreign currency translation adjustment | (69 )          | (105 )  | 49             | (191 )    |
| Total comprehensive loss                | \$(1,172)      | \$2,095 | \$(3,457)      | \$(7,399) |

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

**Lenco Mobile Inc.****Condensed Consolidated Statements of Cash Flows**

|   | Six Months<br>Ended June 30,<br>2014    2013<br>(In thousands) |           |
|---|--|-----------|
| Cash flows from operating activities:                                       |  |           |
| Net loss attributable to Lenco Mobile Inc.                                  | \$(3,506)  | \$(7,208) |
| Adjustments to reconcile net loss to net cash used in operating activities: |  |           |
| Valuation of reclassified equity contracts                                  | (1,261)  | 2,490     |
| Change attributable to noncontrolling interest                              | -  | -         |
| Depreciation and amortization   | 216  | 602       |
| Allowance for doubtful accounts   | (140 )   | 116       |
| Stock compensation expense  | 1,113  | 949       |
| Amortization of debt discount   | 377  | 163       |
| Changes in operating assets and liabilities:                                |  |           |
| Accounts receivable   | 774  | (2,014)   |
| Other current and non-current assets  | 105  | (197 )    |
| Accounts payable, accrued expenses, and other current liabilities           | 2,179  | 1,534     |
| Other   | -  | 186       |
| Net cash used in operating activities                                       | (143 )   | (3,379)   |
| Cash flows from financing activities:                                       |  |           |
| Payment of debt   | -  | -         |
| Proceeds from issuance of Series A Preferred Stock                          | -  | 174       |
| Proceeds from issuance of Series A1 Preferred Stock                         | -  | 1,150     |
| Proceeds from issuance of Notes   | -  | 2,600     |
| Net cash provided by financing activities                                   | -  | 3,924     |
| Effect of exchange rate changes on cash and cash equivalents                | 56   | (76 )     |
| Net change in cash and cash equivalents                                     | (87 )  | 469       |
| Cash and cash equivalents, beginning of period                              | 513  | 618       |
| Cash and cash equivalents, end of period                                    | \$426  | \$1,087   |
| Supplemental disclosure of non-cash investing and financing activities:     |  |           |
| Preferred stock dividends and accretions                                    | \$(948 )   | \$(1,012) |
| Conversion of Retention Bonus for Series A Preferred                        | \$-  | \$1,200   |

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



**LENCO MOBILE INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Summary of Significant Accounting Principles**

*Basis of Presentation and Principals of Consolidation*

The condensed consolidated financial statements include the accounts of the Company and our wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated upon consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and note disclosures required by U.S. generally accepted accounting principles for complete financial statements. The accompanying unaudited financial information should be read in conjunction with the audited consolidated financial statements, including the notes thereto, as of and for the year ended December 31, 2013, included in our 2013 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the "SEC"). The information furnished in this report reflects all adjustments (consisting of normal recurring adjustments), which are, in the opinion of management, necessary for a fair presentation of our financial position, results of operations and cash flows for each period presented. The results of operations for the interim period ended June 30, 2014 are not necessarily indicative of the results for the year ending December 31, 2014 or for any future period.

*Reclassifications*

Certain amounts for prior periods have been reclassified in the condensed consolidated financial statements to conform to the classification used in fiscal year 2014.

*Recent accounting pronouncements*

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"). ASU 2014-09 is intended to improve the financial reporting requirements for revenue from contracts with customers

by providing a principle based approach. The core principle of the standard is that revenue should be recognized when the transfer of promised goods or services is made in an amount that the entity expects to be entitled to in exchange for the transfer of goods and services. ASU 2014-09 also requires disclosures enabling users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. This standard will be effective for financial statements issued by public companies for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the potential impact of ASU 2014-09 on the consolidated financial statements.

#### *Fair Value of Financial Instruments*

The carrying values of our cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and short-term debt approximate their fair values due to their short maturities. The carrying values of our long-term liabilities approximate their fair values based on current rates of interest for instruments with similar characteristics.

#### **Note 2. Liquidity**

As of June 30, 2014, we had cash and cash equivalents of approximately \$0.4 million and a working capital deficit of \$28.0 million. We incurred a net loss of \$3.5 million and net cash used in operations of \$0.1 million for the six months ended June 30, 2014. To date, we have funded our operations primarily through sales of our common stock, convertible preferred stock, and debt financing arrangements.

Management is continuing its efforts to improve quarterly profits by enhancing revenue generation and managing the Company's cost structure, while at the same time ensuring the Company has the resources to meet demand from its customers.

We require additional capital to support our working capital needs in the future. Our ability to fund our capital needs will depend on many factors, including our future operating performance, our ability to successfully realign our costs or the effect of any strategic and financing alternatives we may pursue. Financing, if available, may be on terms that are significantly dilutive to our stockholders, and the prices at which investors would be willing to purchase our securities may be lower than the current price of our common stock. The holders of new securities may also receive rights, preferences or privileges that are senior to those of existing holders of our common stock. If new sources of financing are required but are insufficient or unavailable, we would be required to modify our growth and operating plans accordingly. If necessary, we may explore strategic transactions that we consider to be in the best interest of the Company, which may include selling of assets, curtailing of operations, or seeking protection under bankruptcy.

#### **Note 3. Commitments and Contingencies**

*Retention Bonus Obligations*

In connection with the acquisition of Archer USA, the Company entered into retention bonus arrangements with certain, key employees. As of June 30, 2014 and December 31, 2013, the outstanding amounts owed under these arrangements were \$2.1 million and \$2.0 million, respectively. Interest accrues at an annual rate of 6% on any outstanding amounts. We do not plan on paying these obligations until such time as our resources permit.

### *Contingencies Related to Historical Operations*

The Company was incorporated in 1999 and became engaged in business in the mobile industry in early 2008. Between 1999 and 2008, the Company was engaged in different lines of business including discount brokerage and financial services, mortgage banking, and apparel. Current management was not involved with the Company prior to early 2008. There may be risks and liabilities resulting from the conduct of the Company's business prior to February 2008 that are unknown to the management of our Company and not disclosed in these financial statements. In the event that any liabilities, liens, judgments, warrants, options, or other claims against the Company arise, these will be recorded when discovered.

### *Series A Preferred Stock*

The Company has received notices from seven shareholders of Series A Preferred Stock that each of them has elected to have the Company redeem the Series A Preferred Stock held by them. As of August 12, 2014, the total amount that would be required to redeem all of the shares of Series A Preferred Stock held by these seven shareholders is approximately \$2.6 million. The Company is not legally able to redeem any shares at this time.

### *Legal Proceedings*

We are involved in a number of claims, proceedings and litigation arising from our operations. In accordance with applicable accounting principles and guidance, we establish a reserve for legal proceedings if and when those matters present loss contingencies that are both probable and reasonably estimable. As of the date of this report, we have not recorded a reserve related to any of the claims, proceedings or actions described below. We continue to monitor these matters for developments that would affect the likelihood of a loss and the reserved amount, if any, thereof, and adjust the amount as appropriate. Moreover, although there is a reasonable possibility that a loss may be incurred in connection with these matters, at this time, based on the status of each matter, the possible loss or range of loss cannot in our view be reasonably estimated because, among other things, (a) the remedies sought are indeterminate or unspecified, (b) the legal and/or factual theories are not well developed; and/or (c) the matters involve complex or novel legal theories.

Archer USA was a party in a proceeding in Copenhagen, Denmark captioned *Cirkelselskabet af 16. Juli 2008 in bankruptcy v. iLoop Mobile, Inc., Vedrorende sag 3, afd. B-1040-12: (Deres j.nr. 1013836)*. This matter was filed in the Copenhagen City Court by the trustee for Cirkelselskabet, formerly iLoop Mobile ApS ("ApS"). ApS was a Danish subsidiary of Archer USA that was declared bankrupt in July 2008. The trustee's claims are based on an asset purchase agreement in December 2007 between Archer USA and ApS. Under the agreement, Archer USA forgave \$2,549,794 of debt owed by ApS to Archer USA in exchange for certain assets allegedly owned by ApS. The Copenhagen City

Court entered a judgment against Archer USA on February 27, 2012, for the amount of the trustee's claim plus expenses. Archer USA filed an appeal on March 26, 2012 with the High Court of Eastern Denmark (*Østre Landsret*). The High Court affirmed the lower court's judgment and awarded the trustee certain incremental expenses. On January 10, 2014, Archer USA appealed the High Court's decision to the Supreme Court of Denmark. The Supreme Court declined to hear Archer USA's appeal and Archer USA has no further opportunities for appeal in Denmark. The judgment entered against Archer USA in Denmark is for \$2,549,794, plus interest of approximately \$1,292,047, and fees of approximately \$168,000. If Archer USA did pay this judgment, the trustee would owe Archer USA, as a creditor of the estate, approximately \$3,000,000 as of June 30, 2014. We believe that it is not probable that Archer USA will pay any amounts as a result of this judgment. We believe the proceedings in the Danish courts suffered from serious violations of United States public policy and due process requirements. In addition, we believe the judgment rendered by the Danish courts is not supported by and offends bankruptcy law and principles of both Denmark and the United States. We intend to vigorously contest the validity and enforceability of this judgment in the United States and to defend against any attempt made to enforce this judgment or collect these amounts.

We are a party to a wage action captioned James O'Brien v. iLoop Mobile, Inc., Lenco Mobile, Inc. and Matthew R. Harris, No. 12-2-12705-1 (King County Superior Court, filed 4/13/2012). Plaintiff claimed breach of contract and failure to pay wages under a 2011 iLoop employment agreement and Archer USA/Lenco Mobile retention bonus agreement between Plaintiff and the Company. The trial court granted summary judgment in defendants' favor, dismissing all claims against Matthew Harris and dismissing all but one claim against the Company. Following trial on the remaining claim, the court entered judgment against Plaintiff and in favor of defendants. The plaintiff has appealed. We believe the trial court was correct in ruling against Plaintiff on all claims and intend to vigorously defend the appeal.

We are a party to an action in Nigeria captioned Skynet Telecommunications Limited, Living the Brand Limited v. Archer Mobile South Africa, Lenco Mobile Inc. USA, Suit No: LD/117/2012 (In the High Court of Lagos State in the Lagos Judicial Division Holden at Lagos, filed March 26, 2012). Plaintiffs claim more than \$100,000,000 in damages for breach of an alleged partnership agreement with Archer Mobile South Africa. We believe the claims are without merit and intend to vigorously defend against them.

**Note 4. Debt**

On August 21, 2012 the Company completed and raised an aggregate of \$4.0 million. The debt financing was completed in three closings, the first on July 30, 2012, the second on August 3, 2012 and the third on August 21, 2012. A portion of these obligations are past due as of the filing date.

Debt consisted of the following:

|   | June<br>30,<br>2014 | December<br>31,<br>2013 |
|---|---------------------|-------------------------|
|   | (In thousands)      |                         |
| Current portion of long-term debt obligations, net of debt discount | 13,126              | 11,579                  |
| Long-term obligations, net of debt discount                         | 1,884               | 1,520                   |
| Total debt  | 15,010              | 13,099                  |

**Note 5. Stock Options and Warrants**

As of June 30, 2014, there were 9.6 million shares of common stock available for issuance pursuant to our equity compensation plans. Awards of stock options, stock appreciation rights, stock, restricted stock, restricted stock units, performance units and performance shares may be granted under the 2012 Incentive Plan. The 2012 Incentive Plan initially authorizes the issuance of up to 53 million shares of our common stock. In conjunction with the adoption of the 2012 Incentive Plan, all prior plans were suspended and no further grants are to be made from those plans. Further, any shares subject to outstanding awards under the prior plans on the effective date of the 2012 Incentive Plan that subsequently cease to be subject to such awards (other than by reason of exercise or settlement of the awards in shares), will automatically become available for issuance under the 2012 Incentive Plan, up to an aggregate maximum of 20.5 million shares.

Changes in our outstanding stock options during the six months ended June 30, 2014 were as follows:

| Number of<br>Stock<br>Options | Weighted<br>Average<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|-------------------------------|------------------------------|---|
|-------------------------------|------------------------------|---|

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|  |            |         |      |
|--|------------|---------|------|
| Outstanding at December 31, 2013             | 53,465,045 | \$ 0.12 |      |
| Granted                                      | 1,200,000  | \$ 0.08 |      |
| Exercised                                    | —          |         |      |
| Cancelled or expired                         | (400,000 ) |         |      |
| Outstanding at June 30, 2014                 | 54,265,045 | \$ 0.11 | 3.55 |
| Exercisable at June 30, 2014                 | 42,673,824 | \$ 0.11 |      |
| Vested and expected to vest at June 30, 2014 | 54,265,045 | \$ 0.11 | 3.55 |

At June 30, 2014, there was approximately \$1.3 million of unamortized stock-based compensation cost related to non-vested stock options issued. That cost is expected to be recognized as an expense over a remaining vesting period of approximately 1.0 years.

Stock based compensation is allocated as follows:

|                            | Three<br>Months<br>ended<br>June 30,<br>2014<br>(in<br>thousands) | Three<br>Months<br>ended<br>June 30,<br>2013<br>(in<br>thousands) | Six Months<br>ended<br>June 30,<br>2014<br>(in<br>thousands) | Six Months<br>ended<br>June 30,<br>2013<br>(in<br>thousands) |
|----------------------------|---|---|--|--|
| Sales and marketing        | \$ 58   | \$ 137  | \$ 483   | \$ 228   |
| General and administrative | 243   | 267   | 511  | 482  |
| Research and development   | 64  | 75  | 119  | 239  |
|                            | \$ 365  | \$ 479  | \$ 1,113   | \$ 949   |

The following table summarizes outstanding warrants to purchase shares of our common stock as of June 30, 2014:

| Date of Issue     | Shares of<br>Common<br>Stock<br>Issuable<br>from<br>Warrants<br>Outstanding<br>as of |                   |                   |
|-------------------|--|-------------------|-------------------|
|                   | June 30,<br>2014   | Exercise<br>Price | Expiration        |
| July 30, 2012     | 6,627,000  | \$ 0.05           | July 30, 2017     |
| August 3, 2012    | 2,667,000  | \$ 0.05           | August 3, 2017    |
| August 21, 2012   | 2,625,000  | \$ 0.05           | August 21, 2017   |
| February 15, 2013 | 12,000,000   | \$ 0.05           | February 15, 2018 |
|                   | 23,919,000   |                   |                   |

#### **Liability For Reclassified Equity Contracts Represented by Potentially Dilutive Securities in Excess of Authorized Number of Common Shares**

In accordance with ASC Topic 815, Derivatives and Hedging, the Company accounts for contracts for the issuance of common stock that are in excess of authorized shares as a liability that is recorded at fair value. This liability is required to be remeasured at each reporting period with any change in value to be included in other income and expense until such time as there is no longer an excess of the number of issued and potentially issuable securities over the number of authorized shares. This condition will change either because of an increase in the authorized number of shares or a reverse stock split as approved by shareholders or a reduction in the number of potentially issuable securities. At that time any existing liability will be eliminated.

On January 1, 2013, the combined total of the Company's issued shares and its potentially issuable shares exceeded the authorized number of shares by 60,100,524 potentially issuable shares. This excess arose because of the conversion features of certain preferred shares that were triggered on that date, and issuances of warrants and stock options. At this initial measurement date, the fair value of the potentially issuable shares in excess of the authorized number of common shares was approximately \$2.0 million, which amount was recorded as a liability for reclassified equity contracts, with a corresponding charge to shareholders' equity. This liability was recorded based on the valuation of the last contracts to contribute to the excess.

As of June 30, 2014, potentially issuable shares in excess of the authorized number of common shares were 61,277,365 potentially issuable shares, represented by warrants, stock options, Series A and Series A/1 preferred

shares, the fair value of which was measured at approximately \$1.3 million. The adjustment to the liability for reclassified equity contracts at that date resulted in a charge to other income and expense of \$0.8 and \$1.3 million for the three and six months then ended. The income or expense has been recorded as valuation of reclassified equity contracts.

## **Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and related notes included elsewhere in this Report and the 2013 audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission (SEC) on April 15, 2014.*

*This Report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "believe," "expect," "intend," "anticipate," "estimate," "may," "will," "can," "plan," "predict," "could," "future," "continue," variations of such words, and similar expressions. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider various factors, including the risks outlined elsewhere in this report under "Item 1A. Risk Factors" and in "Item 1A. Risk Factors" of our most recent Annual Report on Form 10-K filed with the SEC. These factors may cause our actual results to differ materially from any forward-looking statements. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.*

### **Overview**

We are a global provider of mobile engagement solutions. Historically, our core operations have been conducted in South Africa through our subsidiary Archer Mobile South Africa Pty Ltd (formerly Capital Supreme (Pty) Ltd. and referred to herein as "Archer South Africa"). In December 2011, we acquired iLoop Mobile Inc. (since renamed Archer USA Inc. and referred to herein as "Archer USA"), a U.S. based mobile marketing technology and services provider. Our strategy is to focus on selling our mobile engagement solutions to large enterprises worldwide. We are an early stage business in a rapidly changing mobile engagement industry.

We were incorporated in 1999 in Delaware under the name of Shochet Holdings Corporation. Prior to 2008, Shochet Holdings Corporation completed an initial public offering, underwent several changes of control and was engaged in several different businesses, which included discount brokerage, financial services, mortgage banking and apparel; ultimately we were operating as a shell company seeking a combination with another operating company. The shell company and its predecessors had generated losses of approximately \$15.8 million which are reflected in our accumulated deficit.

### **Results of Operations**

The discussion below pertains only to our results of operations on a condensed consolidated basis for the periods presented. The period-to-period comparison of financial results is not necessarily indicative of future results.

### Consolidated Statements of Operations Data:

|                                     | Three Months Ended June 30,<br>(In thousands, except share data) |         |           |             | Six Months Ended June 30,<br>(In thousands, except share data) |           |         |             |   |  |
|-------------------------------------|--|---------|-----------|-------------|--|-----------|---------|-------------|---|--|
|                                     | 2014   | 2013    | Diff      | %<br>Change | 2014   | 2013      | Diff    | %<br>Change |   |  |
| Revenue                             | \$4,243  | \$4,104 | \$139     | 3           | % \$7,873  | \$7,765   | \$108   | 1           | % |  |
| Cost of sales                       | 1,911  | 2,196   | (285 )    | -13         | % 3,606  | 3,612     | (6 )    | 0           | % |  |
| Gross profit                        | 2,332  | 1,908   | 424       | 22          | % 4,267  | 4,153     | 114     | 3           | % |  |
| Sales and marketing                 | 746  | 972     | (226 )    | -23         | % 1,772  | 2,203     | (431 )  | -20         | % |  |
| General and administrative          | 1,590  | 1,570   | 20        | 1           | % 3,213  | 3,130     | 83      | 3           | % |  |
| Research and development            | 994  | 1,165   | (171 )    | -15         | % 1,974  | 1,987     | (13 )   | -1          | % |  |
| Depreciation and amortization       | 104  | 297     | (193 )    | -65         | % 216  | 602       | (386 )  | -64         | % |  |
| Loss from operations                | (1,102)  | (2,096) | 994       | 47          | % (2,908)  | (3,769)   | 861     | 23          | % |  |
| Total other expense                 | (36 )  | 4,268   | (4,304)   | -101        | % (725 )   | (3,450)   | 2,725   | -79         | % |  |
| Loss before income taxes            | (1,138)  | 2,172   | (3,310)   | -152        | % (3,633)  | (7,219)   | 3,586   | -50         | % |  |
| Income tax expense (benefit)        | (35 )  | (28 )   | (7 )      | -25         | % (127 )   | (11 )     | (116 )  | -1055       | % |  |
| Net income (loss)                   | \$(1,103)  | \$2,200 | \$(3,303) | -150        | % \$(3,506)  | \$(7,208) | \$3,702 | -51         | % |  |
| Basic income (net loss) per share   | \$(0.04 )  | \$0.02  |           |             | \$(0.04 )  | \$(0.10 ) |         |             |   |  |
| Diluted income (net loss) per share | \$(0.04 )  | \$0.01  |           |             | \$(0.04 )  | \$(0.10 ) |         |             |   |  |

**Balance Sheet Data:**

|  | As of          |          |
|--|----------------|----------|
|  | June 30,       | June 30, |
|  | 2014           | 2013     |
|  | (in thousands) |          |
| Balance sheet data:                                    |                |          |
| Cash and cash equivalents and accounts receivable, net | \$2,553        | \$4,817  |
| Fixed assets, net                                      | 150            | 290      |
| Total assets   | 6,550          | 27,217   |
| Current liabilities                                    | 30,751         | 22,030   |
| Working capital  | (28,054)       | (16,790) |

***Quarter Ended June 30, 2014 Compared to Quarter Ended June 30, 2013****Revenues*

Revenue for the three months ended June 30, 2014 was \$4.2 million compared to the revenue in the same period in 2013 of \$4.1 million.

*Cost of Sales*

For the three months ended June 30, 2014 and 2013 cost of sales were \$1.9 million and \$2.2 million respectively. Our cost of sales varies depending on the change in product mix, including the mix among types of messaging, and the cost of delivering messages through different aggregators and carriers.

*Gross Profit*

Gross Profit margin increased to 55% from 46%. Our consolidated gross margin varies for a number of reasons, including any changes in product mix, including the mix among types of messaging, and the cost of delivering messages through different aggregators and carriers. As a result, period to period comparisons of our gross margin may not provide meaningful information concerning expected future results.

*Operating Expenses*

For the three months ended June 30, 2014 operating expenses decreased to \$3.4 million compared to \$4.0 million for the three months ended June 30, 2013.

*Operating Income (Loss)*

For the three months ended June 30, 2014, the Company's loss from operations was \$1.1 million, compared to a loss of \$2.1 million for the three months ended June 30, 2013.

*Other Income (Expense)*

As of June 30, 2014 the fair value of the shares in excess of the authorized shares was approximately \$1.3 million which resulted in a charge to other income during the quarter of approximately \$0.8 million.

*Provision for Income Taxes*

Benefit of approximately of \$0.05 million was recorded for the three months ended June, 2014 and June 2013.

*Six Months Ended June 30, 2014 Compared to Six Months Ended June 30, 2013*

*Revenues*

Revenue for the six months ended June 30, 2014 was \$7.9 million compared to the revenue in the same period in 2013 of \$7.8 million.

*Cost of Sales*

For the six months ended June 30, 2014 and 2013 cost of sales were \$3.6 and \$3.6 million respectively. Our cost of sales varies depending on the change in product mix, including the mix among types of messaging, and the cost of delivering messages through different aggregators and carriers.

*Gross Profit*

Gross Profit margin increased to 54% from 53%. Our consolidated gross margin varies for a number of reasons, including any changes in product mix, including the mix among types of messaging, and the cost of delivering messages through different aggregators and carriers. As a result, period to period comparisons of our gross margin may not provide meaningful information concerning expected future results.

*Operating Expenses*

For the six months ended June 30, 2014 operating expenses decreased to \$7.2 million compared to \$7.9 million for the six months ended June 30, 2013.

*Operating Loss*

For the six months ended June 30, 2014, the Company's loss from operations was \$2.9 million, compared to a loss of \$3.7 million for the six months ended June 30, 2013.

*Other Income (Expense)*

As of June 30, 2014 the fair value of the shares in excess of the authorized shares was approximately \$1.3 million which resulted in a charge to other income during the quarter of approximately \$0.8 million, which resulted in a charge to other income of approximately \$1.3 million for the six months ended June 30, 2014.

*Provision for Income Taxes*

Benefit of approximately of \$0.1 million was recorded for the six months ended June 2014.

**Liquidity, Going Concern and Capital Resources**

As of June 30, 2014, we had cash and cash equivalents of approximately \$0.4 million and a working capital deficit of \$28.0 million. We incurred a net loss of \$3.5 million and net cash used in operations of \$0.1 million for the six months ended June 30, 2014. To date, we have funded our operations primarily through sales of our common stock, convertible preferred stock, and debt financing arrangements.

Management is continuing to manage the Company's cost structure on a quarterly basis with the objective of improving profitability, while at the same time ensuring the Company has sufficient resources to meet demand from its customers.

We require additional capital to support our working capital needs in the future. Our ability to fund our capital needs will depend on many factors, including our future operating performance, our ability to successfully realign our costs or the effect of any strategic and financing alternatives we may pursue. Financing, if available, may be on terms that are significantly dilutive to our stockholders, and the prices at which investors would be willing to purchase our securities may be lower than the current price of our common stock. The holders of new securities may also receive rights, preferences or privileges that are senior to those of existing holders of our common stock. If new sources of financing are required but are insufficient or unavailable, we would be required to modify our growth and operating plans accordingly. If necessary, we may explore strategic transactions that we consider to be in the best interest of the Company, which may include selling of assets, curtailing of operations, or seeking protection under bankruptcy.



### *Discussion of Cash Flows*

We used cash of approximately \$0.1 million and \$3.4 million in our operating activities in the six months ended June 30, 2014 and 2013.

### **Off-Balance Sheet Arrangements**

As of June 30, 2014, we did not have any off-balance sheet arrangements that have or are reasonably likely to have current or future effect on our financial condition, revenues or expenses, results of operations, liquidity or capital resources that are material to investors. In accordance with our normal business practices, we indemnify our officers and directors. We also have contractual indemnification obligations to our customers relating to third-party content and operating systems that we provide to our customers

### **ITEM 4. CONTROLS AND PROCEDURES.**

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of senior management, including Mr. Matthew Harris, our Chief Executive Officer (“CEO”) and Mr. Douglas Durst, our Chief Financial Officer (“CFO”), of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were not effective because of certain material weaknesses in our internal control over financial reporting that we described under Item 9A in our Annual Report on Form 10-K for the year ended December 31, 2013, which we filed with the SEC on April 15, 2014 (the “Annual Report”). In the Annual Report we described the remediation efforts we have begun to undertake in order to correct such deficiencies. As of June 30, 2014, the deficiencies described in the Annual Report still existed since the remediation efforts had not yet been fully implemented as of that date. There have been no changes in our internal controls over financial reporting or in other factors during the fiscal quarter ended June 30, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting subsequent to the date we carried out our most recent evaluation.

During the three months ended June 30, 2014 there is no longer a separate Audit Committee due to some of the members resigning their position. Currently, the entire board serves as the Audit Committee. At this time, management is evaluating the future effect on the Company’s assessment of disclosure controls and procedures.



## PART II – OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS.

We are involved in a number of claims, proceedings and litigation arising from our operations. In accordance with applicable accounting principles and guidance, we establish a reserve for legal proceedings if and when those matters present loss contingencies that are both probable and reasonably estimable. As of the date of this report, we have not recorded a reserve related to any of the claims, proceedings or actions described below. We continue to monitor these matters for developments that would affect the likelihood of a loss and the reserved amount, if any, thereof, and adjusts the amount as appropriate. Moreover, although there is a reasonable possibility that a loss may be incurred in connection with these matters, at this time, based on the status of each matter, the possible loss or range of loss cannot in our view be reasonably estimated because, among other things, (a) the remedies sought are indeterminate or unspecified, (b) the legal and/or factual theories are not well developed; and/or (c) the matters involve complex or novel legal theories.

Archer USA was a party in a proceeding in Copenhagen, Denmark captioned *Cirkelselskabet af 16. Juli 2008 in bankruptcy v. iLoop Mobile, Inc., Vedrorende sag 3, afd. B-1040-12: (Deres j.nr. 1013836)*. This matter was filed in the Copenhagen City Court by the trustee for Cirkelselskabet, formerly iLoop Mobile ApS (“ApS”). ApS was a Danish subsidiary of Archer USA that was declared bankrupt in July 2008. The trustee’s claims are based on an asset purchase agreement in December 2007 between Archer USA and ApS. Under the agreement, Archer USA forgave \$2,549,794 of debt owed by ApS to Archer USA in exchange for certain assets allegedly owned by ApS. The Copenhagen City Court entered a judgment against Archer USA on February 27, 2012, for the amount of the trustee’s claim plus expenses. Archer USA filed an appeal on March 26, 2012 with the High Court of Eastern Denmark (*Østre Landsret*). The High Court affirmed the lower court’s judgment and awarded the trustee certain incremental expenses. On January 10, 2014, Archer USA appealed the High Court’s decision to the Supreme Court of Denmark. The Supreme Court declined to hear Archer USA’s appeal and Archer USA has no further opportunities for appeal in Denmark. The judgment entered against Archer USA in Denmark is for \$2,549,794, plus interest of approximately \$1,292,047, and fees of approximately \$168,000. If Archer USA did pay this judgment, the trustee would owe Archer USA, as a creditor of the estate, approximately \$3,000,000 as of June 30, 2014. We believe that it is not probable that Archer USA will pay any amounts as a result of this judgment. We believe the proceedings in the Danish courts suffered from serious violations of United States public policy and due process requirements. In addition, we believe the judgment rendered by the Danish courts is not supported by and offends bankruptcy law and principles of both Denmark and the United States. We intend to vigorously contest the validity and enforceability of this judgment in the United States and to defend against any attempt made to enforce this judgment or collect these amounts.

We are a party to a wage action captioned *James O’Brien v. iLoop Mobile, Inc., Lenco Mobile, Inc. and Matthew R. Harris*, No. 12-2-12705-1 (King County Superior Court, filed 4/13/2012). Plaintiff claimed breach of contract and failure to pay wages under a 2011 iLoop employment agreement and Archer USA/Lenco Mobile retention bonus agreement between Plaintiff and the Company. The trial court granted summary judgment in defendants’ favor, dismissing all claims against Matthew Harris and dismissing all but one claim against the Company. Following trial

on the remaining claim, the court entered judgment against Plaintiff and in favor of defendants. The plaintiff has appealed. We believe the trial court was correct in ruling against Plaintiff on all claims and intend to vigorously defend the appeal.

We are a party to an action in Nigeria captioned Skynet Telecommunications Limited, Living the Brand Limited v. Archer Mobile South Africa, Lenco Mobile Inc. USA, Suit No: LD/117/2012 (In the High Court of Lagos State in the Lagos Judicial Division Holden at Lagos, filed March 26, 2012). Plaintiffs claim more than \$100,000,000 in damages for breach of an alleged partnership agreement with Archer Mobile South Africa. We believe the claims are without merit and intend to vigorously defend against them.

**Item 1A. Risk Factors.**

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013, which we filed with the SEC on April 15, 2014.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

None

**ITEM 3. EXHIBITS.**

The exhibits required by this item are listed on the Exhibit Index attached hereto.

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.



**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: August 19, 2014 LENCO MOBILE INC.

By: /s/ Matthew Harris  
Matthew Harris  
Chief Executive Officer

Dated: August 19, 2014 LENCO MOBILE INC.

By: /s/ Doug Durst  
Doug Durst, Chief Financial Officer  
(Principal Accounting Officer)



**EXHIBIT INDEX**

| <b><u>Exhibit No.</u></b> | <b><u>Description</u></b>  |
|---------------------------|--|
| 4.1                       | Form of Note Purchase and Security Agreement Filed as Exhibit 4.1 to the registrant's Form 8-K filed on June 18, 2013 and incorporated herein by reference (Commission File No. 000-153830). |
| 4.2                       | Form of Promissory Note Filed as Exhibit 4.2 to the registrant's Form 8-K filed on June 18, 2013 and incorporated herein by reference (Commission File No. 000-153830).                      |
| 31.1                      | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer  |
| 31.2                      | Rule 13a-14(a)/15d-14(a) Certification of Chief Accounting Officer   |
| 32                        | Section 1350 Certification   |
| 101.INS                   | XBRL Instance Document   |
| 101.SCH                   | XBRL Schema Document   |
| 101.CAL                   | XBRL Calculation Linkbase Document   |
| 101.DEF                   | XBRL Definition Linkbase Document  |
| 101.LAB                   | XBRL Label Linkbase Document   |
| 101.PRE                   | XBRL Presentation Linkbase Document  |