

COMMERCETEL CORP  
Form 10-Q  
August 14, 2012

---

---

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the fiscal quarterly period ended June 30, 2012

Commission file number 000-53851

CommerceTel Corporation  
(Exact Name of Registrant as Specified in Its Charter)

Nevada  
(State or Other Jurisdiction of  
Incorporation or Organization)

26-3439095  
(I.R.S. Employer  
Identification No.)

58 W. Buffalo St. #200  
Chandler, AZ 85225  
(Address of Principal Executive Offices & Zip Code)

(866) 622-4261  
(Telephone Number)

Dennis Becker  
CommerceTel Corporation  
58 W. Buffalo St. #200  
Chandler, AZ 85225

Telephone & Facsimile (866) 622-4261

(Name, Address and Telephone Number of Agent for Service)

Securities registered pursuant to Section 12(b) of the Act:  
None

Securities registered pursuant to section 12(g) of the Act:  
Common Stock, \$.001 par value

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

[ ]

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

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

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

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

As of August 10, 2012, the registrant had 23,214,749 shares of common stock issued and outstanding.

---

---

---

Table of ContentsCOMMERCETEL CORPORATION  
INDEX

	Page
<u>Part I</u> <u>Financial Information</u>	1
<u>Item 1.</u> <u>Financial Statements</u>	1
	<u>Consolidated Balance Sheets</u> 1
	<u>Consolidated Statements of Operations</u> 2
	<u>Consolidated Statement of Stockholders' Equity (Deficit)</u> 3
	<u>Consolidated Statements of Cash Flows</u> 4
	<u>Notes to Consolidated Financial Statements</u> 5
<u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	32
<u>Item 4.</u> <u>Controls and Procedures</u>	32
<u>Part II</u> <u>Other Information</u>	34
<u>Item 1.</u> <u>Legal Proceedings</u>	34
<u>Item 1A.</u> <u>Risk Factors</u>	34
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
<u>Item 3.</u> <u>Defaults Upon Senior Securities</u>	41
<u>Item 4.</u> <u>Removed and Reserved</u>	41
<u>Item 5.</u> <u>Other Information</u>	41
<u>Item 6.</u> <u>Exhibits</u>	41
<u>Signatures</u>	42

Table of Contents

## Part I Financial Information

## Item 1. Financial Statements.

CommerceTel Corporation  
Consolidated Balance Sheets

	June 30, 2012 (Unaudited)	December 31, 2011 (Audited)
Current assets		
Cash	\$ 1,053,573	\$ 396
Accounts receivable, net of allowance for doubtful accounts of \$86,729 and \$18,050, respectively	274,906	243,846
Other current assets	726,983	15,924
Total current assets	2,055,462	260,166
Equipment, net		
Goodwill	21,100	25,316
Intangible assets, net	3,002,070	3,002,070
Other assets	828,508	1,116,506
TOTAL ASSETS	\$ 5,957,317	\$ 4,601,104
Current liabilities		
Accounts payable	\$ 653,160	\$ 842,777
Accrued interest	76,375	130,426
Accrued and deferred personnel compensation	214,865	237,691
Deferred revenue - related party	116,000	200,000
Deferred revenue and customer deposits	123,914	126,525
Convertible notes payable, net of discount	2,569,778	1,002,730
Notes payable, net of discount	217,225	736,270
Cash payment obligation, net of discount	-	86,714
Derivative liabilities	2,910,776	1,573,859
Other current liabilities	699,350	245,227
Earn-out payable	2,581,456	-
Total current liabilities	10,162,899	5,182,219
Non-current liabilities		
Long term accounts payable	-	125,846
Earn-out payable	-	2,658,238
Total non-current liabilities	-	2,784,084
Total liabilities	10,162,899	7,966,303
Commitments and contingencies (See Note 11)		
Stockholders' equity (deficit)		
Common stock, \$0.001 par value; 150,000,000 shares authorized; 23,214,749 and 22,754,308 shares issued and outstanding as of June 30, 2012 and		

Edgar Filing: COMMERCETEL CORP - Form 10-Q

December 31, 2011, respectively	23,214	22,754
Additional paid-in capital	22,942,231	21,099,289
Accumulated deficit	(27,171,027 )	(24,487,242 )
Total stockholders' equity (deficit)	(4,205,582 )	(3,365,199 )
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS' EQUITY (DEFICIT) \$</b>	<b>5,957,317</b>	<b>\$ 4,601,104</b>

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

CommerceTel Corporation  
Consolidated Statements of Operations  
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011 (Restated)	2012	2011 (Restated)
<b>Revenues</b>				
Revenues	\$1,009,398	\$553,108	\$2,022,604	\$693,746
Cost of revenues	332,458	179,051	700,228	258,888
Gross margin	676,940	374,057	1,322,376	434,858
<b>Operating expenses</b>				
General & administrative	797,763	559,635	1,717,256	1,183,849
Sales & marketing	381,868	216,085	729,119	280,010
Engineering, research, & development	134,780	179,273	293,081	325,764
Depreciation & amortization	146,765	124,741	301,382	126,778
Total operating expenses	1,461,176	1,079,734	3,040,838	1,916,401
Loss from operations	(784,236 )	(705,677 )	(1,718,462 )	(1,481,543 )
<b>Other income/(expense)</b>				
Interest income	2,568	16	2,568	174
Interest expense, net	(880,321 )	(138,258 )	(1,238,499 )	(243,666 )
Change in fair market value of derivative liabilities	654,477	(154,104 )	193,990	(584,506 )
Loss on sale of asset	(164 )	-	(164 )	-
Gain on adjustment in contingent consideration	16,131	-	76,782	-
Total other income/(expense)	(207,309 )	(292,346 )	(965,323 )	(827,998 )
Loss before income taxes	(991,545 )	(998,023 )	(2,683,785 )	(2,309,541 )
Income tax expense	-	38	-	38
Net loss	\$(991,545 )	\$(997,985 )	\$(2,683,785 )	\$(2,309,503 )
Net loss per share - basic and diluted	\$(0.04 )	\$(0.05 )	\$(0.12 )	\$(0.12 )
<b>Weighted average number of shares</b>				
during the period - basic and diluted	23,041,215	21,336,579	22,920,101	19,534,081

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

CommerceTel Corporation  
 Consolidated Statements of Stockholders' Equity (Deficit)  
 (Unaudited)

	Common Stock		Additional	Accumulated	Total
	Shares	Amount	Paid-In Capital	Deficit	Stockholders' Equity (Deficit)
Balance, December 31, 2011	22,754,308	\$22,754	\$21,099,289	\$(24,487,242)	\$ (3,365,199 )
Issuance of common stock for services	225,000	225	269,775	-	270,000
Issuance of common stock for late payment	235,441	235	160,223	-	160,468
Stock-based compensation	-	-	210,429	-	210,429
Adjustment to derivative liability due to debt repayment	-	-	181,646	-	181,646
Adjustment to derivative liability due to debt conversion	-	-	1,020,859	-	1,020,859
Net loss for the six months ended June 30, 2012	-	-	-	(2,683,785 )	(2,683,785 )
Balance, June 30, 2012	23,214,749	\$23,214	\$22,942,231	\$(27,171,027)	\$ (4,205,582 )

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

CommerceTel Corporation  
Consolidated Statements of Cash Flows  
(Unaudited)

	Six months ended June 30,	
	2012	2011 (Restated)
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (2,683,785 )	\$ (2,309,503 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Bad debt expense	79,179	6,203
Common stock for services	270,000	-
Stock-based compensation	210,429	596,336
Stock issued for late payment	160,468	-
Depreciation and amortization expense	301,382	126,778
Gain on adjustment in contingent consideration	(76,782 )	-
Change in fair market value of derivative liabilities	(193,990 )	584,506
Amortization of deferred financing costs	100,857	20,000
Amortization of note discounts	1,020,749	161,565
Loss on sale of assets	164	-
Increase (decrease) in cash resulting from changes in:		
Accounts receivable	(110,239 )	(111,966 )
Other current assets	(540,553 )	34,362
Other assets	(2,060 )	(41,433 )
Accounts payable	(189,617 )	152,145
Accrued interest	83,598	53,727
Accrued and deferred personnel compensation	(22,826 )	8,161
Deferred revenue and customer deposits	(86,611 )	90,321
Other liabilities	454,123	29,346
Net cash used in operating activities	(1,225,514 )	(599,452 )
<b>INVESTING ACTIVITIES</b>		
Purchases of equipment	(9,732 )	(6,186 )
Acquisition of intangible assets	-	(75,001 )
Cash paid for acquisitions	-	(91,153 )
Net cash used in investing activities	(9,732 )	(172,340 )
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of notes payable, net of finance offering costs	3,148,470	10,000
Payments on notes payable	(772,547 )	(97,153 )
Payments on cash payment obligation	(87,500 )	(25,000 )
Proceeds from issuance of common stock and warrants, net of equity offering costs	-	533,701
Net cash provided by financing activities	2,288,423	421,548
Net change in cash	1,053,177	(350,244 )
Cash at beginning of period	396	373,439
Cash at end of period	\$ 1,053,573	\$ 23,195



## Supplemental disclosures:

## Cash paid during period for :

Interest	\$	33,108	\$	3,113
Non cash investing and financing activities:				
Common stock issued for patents and trademarks	\$	-	\$	50,000
Debt discount	\$	2,733,412	\$	-
Adjustment to derivative liability due to debt repayment	\$	181,646	\$	-
Adjustment to derivative liability due to debt conversion	\$	1,020,859	\$	-
Conversion of accrued interest into debt	\$	137,649	\$	-
Fair value of assets acquired in acquisitions	\$	-	\$	41,414
Customer contracts	-			1,026,000
Customer relationships	-			814,000
Trade name	-			101,000
Technology / IP	-			399,000
Non-compete	-			6,000
Goodwill	-			9,063,763
Assumed liabilities - deferred revenue	-			(20,000 )
Subordinated secured note payable	-			(606,064 )
Cash payment obligation	-			(241,960 )
Common stock issued for acquisitions	-			(10,492,000 )
Cash paid for acquisitions	\$	-	\$	91,153

See accompanying notes to consolidated financial statements (unaudited).

Table of Contents

CommerceTel Corporation  
Notes to Consolidated Financial Statements  
(Unaudited)

1. Reverse Merger Transaction and Accounting

Reverse Merger Transaction

CommerceTel Corporation (the “Company”) was incorporated as Ares Ventures Corporation in Nevada in 2008, and was renamed CommerceTel Corporation in 2010. On November 2, 2010, the Company acquired CommerceTel, Inc., which was wholly-owned by CommerceTel Canada Corporation (“CTel Canada” or “our former parent”), in a reverse merger, or the “Merger”. Pursuant to the Merger, all of the issued and outstanding shares of CommerceTel, Inc. common stock were converted, at an exchange ratio of 0.7268-for-1, into an aggregate of 10,000,000 shares of the Company’s common stock, and CommerceTel, Inc. became a wholly owned subsidiary of the Company. The accompanying condensed consolidated financial statements, common share and weighted average common share basic and diluted information has been retroactively adjusted to reflect the exchange ratio in the Merger.

Reverse Merger Accounting

Immediately following the consummation of the Merger, the: (i) former security holders of CommerceTel, Inc. common stock had an approximate 56% voting interest in the Company and the Company stockholders retained an approximate 44% voting interest, (ii) former executive management team of CommerceTel, Inc. remained as the only continuing executive management team for the Company, and (iii) Company’s ongoing operations consist solely of the ongoing operations of CommerceTel, Inc. Based primarily on these factors, the Merger was accounted for as a reverse merger and a recapitalization in accordance with generally accepted accounting principles in the United States of America, or “GAAP”. As a result, these condensed financial statements reflect the: (i) historical results of CommerceTel, Inc. prior to the Merger, (ii) combined results of the Company following the Merger, and (iii) acquired assets and liabilities at their historical cost. In connection with the Merger, the Company received net assets of \$16,496.

On December 7, 2010, the Board of Directors of the Company resolved to change the Company’s fiscal year end from September 30 to December 31, effective immediately, to coincide with the fiscal year end of its wholly owned subsidiary CommerceTel, Inc.

2. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Basis of Presentation

The Company is a provider of mobile marketing technology that enables major brands and enterprises to engage consumers via their mobile phones and other smart devices. Interactive electronic communications with consumers is a complex process involving communication networks and software. The Company removes this complexity through its suite of services and technologies thereby enabling brands, marketers, and content owners to communicate with their customers and consumers in general.

Principles of Accounting and Consolidation

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All significant intercompany balances and transactions have been eliminated.

## Going Concern

The Company's financial statements have been prepared assuming that it will continue as a going concern. Such assumption contemplates the realization of assets and satisfaction of liabilities in the normal course of business.

However, we have incurred continued losses, have a net working capital deficiency, and have an accumulated deficit of approximately (\$27.2) million as of June 30, 2012. These factors among others create a substantial doubt about our ability to continue as a going concern. The Company is dependent upon sufficient future revenues, additional sales of our securities or obtaining debt financing in order to meet its operating cash requirements. Barring the Company's generation of revenues in excess of its costs and expenses or its obtaining additional funds from equity or debt financing, or receipt of significant licensing prepayments, the Company will not have sufficient cash to continue to fund the operations of the Company through June 30, 2013. These unaudited consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

In response to our Company's cash needs, we raised additional bridge financing totaling \$3,396,350 between January and June, 2012. Longer term, we anticipate that we will raise additional equity financing through the sale of shares of the Company's common stock in order to finance our future investing and operating cash flow needs. However, there can be no assurance that such financings will be available on acceptable terms, or at all.

## Table of Contents

We anticipate, based on currently proposed plans and assumptions relating to our ability to market and sell our products, that our cash on hand will not satisfy, our operational and capital requirements for the next 12 months. Further, the operation of our business and our efforts to grow our business further both through acquisitions and organically will require significant cash outlays and commitments. The timing and amount of our cash needs may vary significantly depending on numerous factors. Our existing working capital is not sufficient to meet our cash requirements and we will need to seek additional capital, potentially through debt, or equity financings, to fund our growth.

Although we are actively pursuing financing opportunities, we may not be able to raise cash on terms acceptable to us or at all. There can be no assurance that we will be successful in obtaining additional funding. Financings, if available, may be on terms that are dilutive to our shareholders, and the prices at which new investors would be willing to purchase our securities may be lower than the current price of our ordinary shares. The holders of new securities may also receive rights, preferences or privileges that are senior to those of existing holders of our ordinary shares. If additional financing is not available or is not available on acceptable terms, we will have to curtail our operations in the short term.

## Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Significant estimates used are those related to stock-based compensation, the valuation of the derivative liabilities, asset impairments, the valuation and useful lives of depreciable tangible and certain intangible assets, the fair value of common stock used in acquisitions of businesses, the fair value of assets and liabilities acquired in acquisitions of businesses, and the valuation allowance of deferred tax assets. Management believes that these estimates are reasonable; however, actual results may differ from these estimates.

## Purchase Accounting

The Company accounts for acquisitions pursuant to Accounting Standards Codification (“ASC”) No. 805, Business Combinations. The Company records all acquired tangible and intangible assets and all assumed liabilities based upon their estimated fair values.

## Cash

The Company minimizes its credit risk associated with cash by periodically evaluating the credit quality of its primary financial institution. The balance at times may exceed federally insured limits. The Company has not experienced any losses on such accounts.

## Fair Value of Financial Instruments

On January 1, 2011, the Company adopted guidance which defines fair value, establishes a framework for using fair value to measure financial assets and liabilities on a recurring basis, and expands disclosures about fair value measurements. Beginning on January 1, 2011, the Company also applied the guidance to non-financial assets and liabilities measured at fair value on a non-recurring basis, which includes goodwill and intangible assets. The guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the

Company's assumptions of what market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of the inputs as follows:

Level 1 - Valuation is based upon unadjusted quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2 - Valuation is based upon quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable in the market.

Level 3 - Valuation is based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own assumptions about the inputs that market participants would use.

-6-

---

Table of Contents

The following table presents assets and liabilities that are measured and recognized at fair value as of June 30, 2012 on a recurring and non-recurring basis:

Description	Level 1	Level 2	Level 3	Gains (Losses)
Intangibles, net (non-recurring)	\$-	\$-	\$828,508	\$-
Goodwill (non-recurring)	\$-	\$-	\$3,002,070	\$-
Derivatives (recurring)	\$-	\$-	\$2,910,776	\$193,990

The following table presents assets and liabilities that are measured and recognized at fair value as of December 31, 2011 on a recurring and non-recurring basis:

Description	Level 1	Level 2	Level 3	Gains (Losses)
Intangibles, net (non-recurring)	\$-	\$-	\$1,116,506	\$(1,325,134 )
Goodwill (non-recurring)	\$-	\$-	\$3,002,070	\$(10,435,170)
Derivatives (recurring)	\$-	\$-	\$1,573,859	\$(1,234,145 )

The Company has goodwill and intangible assets as a result of the business combinations that were completed during 2011 and that are discussed throughout this form 10-Q. These assets were valued with the assistance of a valuation consultant and consisted of Level 3 valuation techniques

The Company has derivative liabilities as a result of 2011 and 2012 convertible promissory notes and common stock and warrants with exercise price reset provisions that include embedded derivatives. These liabilities were valued with the assistance of a valuation consultant and consisted of Level 3 valuation techniques.

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and long-term debt. The estimated fair value of cash, accounts receivable, accounts payable and accrued liabilities approximate their carrying amounts due to the short-term nature of these instruments. The carrying value of long-term debt also approximates fair value since their terms are similar to those in the lending market for comparable loans with comparable risks. None of these instruments are held for trading purposes.

#### Accounts Receivable

Accounts receivable are carried at their estimated collectible amounts. The Company grants unsecured credit to substantially all of its customers. Ongoing credit evaluations are performed and potential credit losses are charged to operations at the time the account receivable is estimated to be uncollectible. Since the Company cannot necessarily predict future changes in the financial stability of its customers, the Company cannot guarantee that its reserves will continue to be adequate.

From time to time, the Company may have a limited number of customers with individually large amounts due. Any unanticipated change in one of the customer's credit worthiness could have a material effect on the results of operations in the period in which such changes or events occurred. The Company recorded an allowance for doubtful accounts of \$86,729 and \$18,050 as of June 30, 2012 and December 31, 2011, respectively. The June 30, 2012, allowance was primarily due to the default of a single client which totaled \$66,525. As of June 30, 2012, the Company had one customer whose balance represented 19% of total accounts receivable. As of December 31, 2011, there were no single customers with balances greater than 10%.

#### Equipment

Equipment, which is recorded at cost, consists primarily of computer equipment and is depreciated using the straight-line method over the estimated useful lives of the related assets (generally five years or less). Costs incurred for maintenance and repairs are expensed as incurred and expenditures for major replacements and improvements are capitalized and depreciated over their estimated remaining useful lives. Depreciation expense for the three months ended June 30, 2012 and 2011 was \$6,766 and \$5,876, respectively. Depreciation expense for the six months ended June 30, 2012 and 2011 was \$13,384 and \$7,160, respectively. Accumulated depreciation for the Company's equipment equaled \$147,404 at June 30, 2012 and \$134,810 at December 31, 2011.

Net property and equipment were as follows:

		June 30, 2012	December 31, 2011
Equipment	\$	153,935	\$ 146,872
Furniture and Fixtures		14,569	13,254
Subtotal		168,504	160,126
Less accumulated depreciation		(147,404 )	(134,810 )
Total	\$	21,100	\$ 25,316

-7-

---

## Table of Contents

### Goodwill and Other Intangible Assets

The Company periodically reviews the carrying value of intangible assets not subject to amortization, including goodwill, to determine whether impairment may exist. Goodwill and certain intangible assets are assessed annually, or when certain triggering events occur, for impairment using fair value measurement techniques. These events could include a significant change in the business climate, legal factors, a decline in operating performance, competition, sale or disposition of a significant portion of the business, or other factors. Specifically, goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is used to identify potential impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. The Company uses Level 3 inputs and a discounted cash flow methodology to estimate the fair value of a reporting unit. A discounted cash flow analysis requires one to make various judgmental assumptions including assumptions about future cash flows, growth rates, and discount rates. The assumptions about future cash flows and growth rates are based on the Company's budget and long-term plans. Discount rate assumptions are based on an assessment of the risk inherent in the respective reporting units. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired and the second step of the impairment test is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

As of June 30, 2012, amortizable intangible assets consist of patents and trademarks, customer contracts, customer relationships, trade name, acquired technology, and non compete agreements. These intangibles are being amortized on a straight line basis over their estimated useful lives of one to five years. The Company recorded amortization of our intangible assets of \$139,999 and \$118,865 for the three months ended June 30, 2012 and 2011, respectively. The Company also recorded amortization of our intangible assets of \$287,999 and \$119,618 for the six months ended June 30, 2012 and 2011, respectively.

### Impairment of Long-Lived Assets

The Company has adopted Accounting Standards Codification subtopic 360-10, Property, Plant and Equipment ("ASC 360-10"). ASC 360-10 requires that long-lived assets and certain identifiable intangibles held and used by the Company be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company evaluates its long-lived assets for impairment annually or more often if events and circumstances warrant. Events relating to recoverability may include significant unfavorable changes in business conditions, recurring losses or a forecasted inability to achieve break-even operating results over an extended period. The Company evaluates the recoverability of long-lived assets based upon forecasted undiscounted cash flows. Should impairment in value be indicated, the carrying value of intangible assets will be adjusted, based on estimates of future discounted cash flows resulting from the use and ultimate disposition of the asset. ASC 360-10 also requires that those assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell.

### Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks.



The Company reviews the terms of the common stock, warrants and convertible debt it issues to determine whether there are embedded derivative instruments, including embedded conversion options, which are required to be bifurcated and accounted for separately as derivative financial instruments. In circumstances where the host instrument contains more than one embedded derivative instrument, including the conversion option, that is required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument.

Bifurcated embedded derivatives are initially recorded at fair value and are then revalued at each reporting date with changes in the fair value reported as non-operating income or expense. When the equity or convertible debt instruments contain embedded derivative instruments that are to be bifurcated and accounted for as liabilities, the total proceeds received are first allocated to the fair value of all the bifurcated derivative instruments. The remaining proceeds, if any, are then allocated to the host instruments themselves, usually resulting in those instruments being recorded at a discount from their face value.

The discount from the face value of the convertible debt, together with the stated interest on the instrument, is amortized over the life of the instrument through periodic charges to interest expense, using the effective interest method.

## Table of Contents

The fair value of the derivatives is estimated using a Monte Carlo simulation model. The model utilizes a series of inputs and assumptions to arrive at a fair value at the date of inception and each reporting period. Some of the key assumptions include the likelihood of future financing, stock price volatility, and discount rates.

### Revenue Recognition

The Company's "C4" Mobile Marketing and Customer Relationship Management (CRM) platform is a hosted solution, as is the newly acquired Txtstation Control Center platform. The Company generates revenue from licensing its software to clients in its software as a service (SaaS) model, per-message and per-minute transactional fees, and customized professional services. The Company recognizes license fees over the period of the contract, service fees as the services are performed, and per-message or per-minute transaction revenue when the transaction takes place. The Company recognizes revenue at the time that the services are rendered, the selling price is fixed, and collection is reasonably assured, provided no significant obligations remain. The Company considers authoritative guidance on multiple deliverables in determining whether each deliverable represents a separate unit of accounting. As for the newly acquired Mobivity and Boomtext platforms, which are both hosted solutions, revenue is principally derived from subscription fees from customers. The subscription fee is billed on a month to month basis with no contractual term and is collected by credit card for Mobivity and collected by cash and credit card for Boomtext. Revenue is recognized at the time that the services are rendered and the selling price is fixed with a set range of plans. Cash received in advance of the performance of services is recorded as deferred revenue. Deferred revenues to related parties totaled \$116,000 at June 30, 2012 and \$200,000 at December 31, 2011. Deferred revenues to third parties totaled \$106,665 at June 30, 2012 and \$109,063 at December 31, 2011.

### Stock-based Compensation

The Company accounts for stock-based compensation in accordance with Financial Accounting Standards Board ("FASB") ASC Topic 718 Stock Compensation, which establishes accounting for equity instruments exchanged for employee services. Under such provisions, stock-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense, under the straight-line method, over the employee's requisite service period (generally the vesting period of the equity grant). In accordance with ASC 718, the Company estimates forfeitures at the time of grant and revises the estimates if necessary, if actual forfeiture rates differ from those estimates. Stock options issued to employees are accounted for at their estimated fair value determined using the Black-Scholes option-pricing model. The Company recorded stock based compensation of \$210,429 and \$596,336 for the six months ended June 30, 2012 and 2011, respectively.

### Long Term Accounts Payable

The company had recorded amounts pertaining to payments made prior to the acquisitions of Boomtext as well as amounts due to it from the sellers of Boomtext in accounts that are included in Other Assets and Long Term Accounts Payable as of the year ended December 31, 2011. The amount recorded as a receivable from the sellers of Boomtext totaled \$248,930, and the amount due to these sellers totaled \$125,846 at December 31, 2011. As of June 30, 2012 these amounts have been reclassified to Other Current Assets and Other Current Liabilities, since these balances will be settled in March of 2013 when the Earn-out payable to Boomtext is paid. The amount recorded as a receivable from the sellers of Boomtext totaled \$538,924 and the amount due to these sellers totaled \$522,224 at June 30, 2012.

### Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. The Company is required to record all components of comprehensive income (loss) in the consolidated financial statements in the period in which they are recognized. Net income (loss)

and other comprehensive income (loss), including foreign currency translation adjustments and unrealized gains and losses on investments, are reported, net of their related tax effect, to arrive at comprehensive income (loss). For the three and six months ended June 30, 2012 and 2011, the comprehensive loss was equal to the net loss.

#### Net Loss Per Common Share

Net loss per share is presented as both basic and diluted net loss per share. Basic net loss per share excludes any dilutive effects of options, shares subject to repurchase and warrants. Diluted net loss per share includes the impact of potentially dilutive securities. During 2012 and 2011, the Company had securities outstanding which could potentially dilute basic earnings per share in the future, but were excluded from the computation of diluted net loss per share, as their effect would have been anti-dilutive. These outstanding securities consist of 1,789,686 outstanding employee options, 930,000 outstanding non-employee warrants and 842,142 outstanding warrants attached to the private placement offering. In addition, see potential issuances associated with warrants and convertible debt in Notes 5 and 6.

#### Reclassifications

Certain amounts from prior periods have been reclassified to conform to the current period presentation.

## Table of Contents

### Recent Accounting Pronouncements

Accounting standards promulgated by the FASB are subject to change. Changes in such standards may have an impact on the Company's future financial statements. The following are a summary of recent accounting developments.

In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This update clarifies the application of certain existing fair value measurement guidance and expands the disclosures for fair value measurements that are estimated using significant unobservable (Level 3) inputs. This update is effective on a prospective basis for annual and interim reporting periods beginning on or after December 15, 2011, which for the Company is January 1, 2012. The Company does not expect that adopting this update will have a material impact on its consolidated financial statements.

In September 2011, the FASB issued ASU No. 2011-08, "Intangibles — Goodwill and Other" (ASU 2011-08). ASU 2011-08 allows a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the two-step goodwill impairment test. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, then the two-step impairment test would be performed. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption is permitted. This update is expected to change the process the Company uses to test goodwill for impairment, but is not expected to have a material impact on its consolidated financial statements.

In December 2011, FASB issued Accounting Standards Update 2011-11, Balance Sheet - Disclosures about Offsetting Assets and Liabilities" to enhance disclosure requirements relating to the offsetting of assets and liabilities on an entity's balance sheet. The update requires enhanced disclosures regarding assets and liabilities that are presented net or gross in the statement of financial position when the right of offset exists, or that are subject to an enforceable master netting arrangement. The new disclosure requirements relating to this update are retrospective and effective for annual and interim periods beginning on or after January 1, 2013. The update only requires additional disclosures, as such, we do not expect that the adoption of this standard will have a material impact on our results of operations, cash flows or financial condition.

### 3. Acquisitions

#### Txtstation Acquisition

On April 1, 2011, the Company acquired substantially all of the assets of the Txtstation interactive mobile marketing platform and services business from Adsparg Limited ("Adsparg"). The purchase price for the acquisition was 2,125,000 shares of the Company's common stock, \$26,184 in cash at closing and \$250,000 of scheduled cash payments. The \$250,000 of scheduled cash payments is due as follows: \$25,000 payable on the 60th day following closing and the balance is payable in \$25,000 installments at the end of each of the next nine 30-day periods thereafter.

The Company also issued 300,000 shares of its common stock to the controlling stockholder of Adsparg in consideration of certain indemnification obligations and other agreements.

The acquisition has been accounted for as a business combination and the Company valued all assets and liabilities acquired at their fair values on the date of acquisition. An independent valuation expert (Vantage Point Advisors) was hired to assist the Company in determining these fair values. Accordingly, the assets and liabilities of the acquired

entity were recorded at their estimated fair values at the date of the acquisition.

#### Mobivity Acquisition

Effective April 1, 2011, the Company completed the acquisition of Mobivity, LLC's and Mobile Visions, Inc.'s Mobivity interactive mobile marketing platform and services business.

The purchase price for the acquisition consisted of 1,000,000 shares of the Company's common stock, \$64,969 in cash paid at closing and a secured subordinated promissory note of CommerceTel, Inc. in the principal amount of \$606,064. The promissory note earns interest at 6.25% per annum; is payable in six quarterly installments of \$105,526 (inclusive of interest) starting May 1, 2011; matures on August 1, 2012 and was repaid in full as discussed in Note 6; is secured by the acquired assets of the Mobivity business; and is subordinated to the Company's obligations under its outstanding 10% Senior Secured Convertible Bridge Notes due October 15, 2012 (see Note 6). Mobivity, LLC was granted a security interest in the acquired assets, subordinated only to the Company's senior debt (Bridge Loan), and a majority of the Bridge Lenders consented to the junior security interest.

The acquisition has been accounted for as a business combination and the Company valued all assets and liabilities acquired at their fair values on the date of acquisition. An independent valuation expert (Vantage Point Advisors) was hired to assist the Company in determining these fair values. Accordingly, the assets and liabilities of the acquired entity were recorded at their estimated fair values at the date of the acquisition.

Table of Contents

## BoomText Acquisition

Effective August 1, 2011, the Company completed the purchase from with Digimark, LLC (“Digimark”) of substantially all of the assets of its BoomText interactive mobile marketing services business. The purchase price for the acquisition consisted of the following components: (i) 519,540 shares of the Company’s common stock issued at closing; (ii) \$120,514 in cash paid at closing; (iii) a secured subordinated promissory note of CommerceTel, Inc. in the principal amount of \$175,000. This note earns interest at 6.25% per annum; is payable in full on May 25th, 2012 (original maturity March 31, 2012 was extended) and was repaid in full as discussed in Note 6; is secured by all of the assets of CommerceTel, Inc. and is subordinated to the Company’s obligations under its outstanding 10% Senior Secured Convertible Bridge Notes due October 15, 2012 (see Note 6); (iv) an unsecured subordinated promissory note in the principal amount of \$194,658 issued by CommerceTel, Inc. This note does not bear interest; is payable in installments (varying in amount) from August 2011 through October 2012; and is subordinated to the Company’s obligations under its outstanding 10% Senior Secured Convertible Bridge Notes due October 15, 2012 (see Note 6); (v) an earn-out payment (payable 20 months after closing of the transaction) of a number of shares of common stock of the Company equal to (a) 1.5, multiplied by the Company’s net revenue from acquired customers and customer prospects for the twelve-month period beginning six months after the closing date, divided by (b) the average of the volume-weighted average trading prices of the Company’s common stock for the 25 trading days immediately preceding the earn-out payment (subject to a collar of \$1.49 and \$2.01 per share). As of June 30, 2012 the dollar value of the earn-out payable is \$2,581,456, which is recorded as a current liability on the accompanying condensed consolidated balance sheet. The estimated number of common shares to be issued to settle the earn-out payable is 4,375,350 as of June 30, 2012. The purchase price also included the assumption of an office lease obligation and certain of Digimark’s accounts payable.

For one year following the closing of the transaction, 50% of the shares of common stock issued to Digimark at closing will be held in escrow as security for its indemnification obligations in the transaction.

The Company completed the acquisition in furtherance of its strategy to acquire small, privately owned enterprises in the mobile marketing sector through an asset purchase structure. This acquisition was consistent with the Company’s purchase price model in which equity will represent most of the purchase price plus a small cash component and, in some cases, the assumption of specific liabilities.

The acquisition has been accounted for as a business combination and the Company valued all assets and liabilities acquired at their fair values on the date of acquisition. An independent valuation expert (Vantage Point Advisors) was hired to assist the Company in determining these fair values. Accordingly, the assets and liabilities of the acquired entity were recorded at their estimated fair values at the date of the acquisition.

## 4. Goodwill and Purchased Intangibles

As required under ASC 350, Intangibles - Goodwill and Other, goodwill is separately disclosed from other intangible assets on the consolidated balance sheet and not amortized, and is tested for impairment on at least an annual basis.

The following table presents details of the Company’s total purchased intangible assets as of June 30, 2012:

	Balance at December 31, 2011	Additions	Amortization	Balance at June 30, 2012
Patents and trademarks	\$120,016	\$-	\$ (4,198 )	\$115,818
Customer contracts	103,000	-	(12,118 )	90,882

Edgar Filing: COMMERCETEL CORP - Form 10-Q

Customer relationships	496,999	-	(174,547 )	322,452
Trade name	70,750	-	(32,206 )	38,544
Technology / IP	322,116	-	(63,347 )	258,770
Non-compete	3,625	-	(1,583 )	2,042
	\$1,116,506	\$-	\$ (287,999 )	\$828,508

During the three and six months ended June 30, 2012, the Company recorded amortization expense related to purchased intangibles of \$139,999 and \$287,999, respectively, which is included in Depreciation & amortization in the Consolidated Statement of Operations.

Table of Contents

The estimated future amortization expense of purchased intangible assets as of June 30, 2012 is as follows:

Year ending December 31,	Amount
2012	\$ 294,337
2013	307,690
2014	101,361
2015	32,631
2016	14,455
Thereafter	\$ 78,034
<b>Total</b>	<b>\$ 828,508</b>

Beginning in 2011, the Company performed its annual goodwill impairment test outlined under ASC 350 which requires the assessment of goodwill for impairment on an annual basis. The assessment of goodwill impairment will be conducted by determining and comparing the fair value of our reporting units, as defined in ASC 350, to the reporting unit's carrying value as of that date. The fair value will be determined using an income approach under which the fair value of the asset is based on the value of the cash flows that the asset can be expected to generate in the future. These estimated future cash flows will be discounted to arrive at their respective fair values.

Beginning in 2011, the Company evaluated its purchased intangibles for possible impairment on an ongoing basis. When impairment indicators exist, the Company will perform an assessment to determine if the intangible asset has been impaired and to what extent. The assessment of purchased intangibles impairment is conducted by first estimating the undiscounted future cash flows to be generated from the use and eventual disposition of the purchased intangibles and comparing this amount with the carrying value of these assets. If the undiscounted cash flows are less than the carrying amounts, impairment exists and future cash flows are discounted at an appropriate rate and compared to the carrying amounts of the purchased intangibles to determine the amount of the impairment.

## 5. Derivative Liabilities

As discussed in Note 6 under Bridge Financing, the Company issued convertible notes payable that provide for the issuance of warrants to purchase its common stock at a future date. The conversion term for the convertible notes is variable based on certain factors. The number of warrants to be issued is based on the future price of the Company's common stock. As of June 30, 2012, the number of warrants to be issued remains indeterminate. Due to the fact that the number of warrants issuable is indeterminate, the equity environment is tainted and all additional warrants and convertible debt are included in the value of the derivative. Pursuant to ASC 815-15 Embedded Derivatives, the fair values of the variable conversion option and warrants / shares to be issued were recorded as derivative liabilities on the issuance date.

In March 2011, the Company commenced a private placement. The private placement structure consists of a series of identical subscription agreements for the sale of units comprised of shares of the Company's common stock at a price of \$1.50 per share and an equivalent number of warrants at an exercise price of \$2.00. Both the common shares and the warrants contain anti-dilutive, or down round, price protection. The down round protection for the common shares terminates on the earlier of the date on which an effective registration statement is filed with the SEC covering the shares, or the shares become freely tradable pursuant to Rule 144 promulgated under the Securities Act of 1933. The down round protection for the warrant terminates when the warrant expires or is exercised. Pursuant to ASC 815-15 Embedded Derivatives and ASC 815-40 Contracts in Entity's Own Equity, the Company determined that the down round price protection on the common stock represents a derivative liability. Additionally, the Company recorded a derivative liability for the warrants issued in the transactions.



The fair values of the Company's derivative liabilities were estimated at the issuance date and are revalued at each subsequent reporting date, using a Monte Carlo simulation. At June 30, 2012, the Company recorded current derivative liabilities of \$2,910,776. The change in fair value of the derivative liabilities for the three months ended June 30, 2012 and 2011 was a gain of \$654,477, and a loss of (\$154,104), respectively, which were reported as other income/(expense) in the consolidated statements of operations. The change in fair value of the derivative liabilities for the six months ended June 30, 2012 and 2011 was a gain of \$193,990, and a loss of (\$584,506), respectively, which were also reported as other income/(expense) in the consolidated statements of operations.

Derivative Value by Instrument Type	June 30, 2012	December 31, 2011
Convertible Bridge Notes	\$ 2,425,029	\$ 747,424
Common Stock and Warrants	260,907	826,435
Non-employee Warrants	224,840	-
	\$ 2,910,776	\$ 1,573,859

Table of Contents

	Total
Beginning balance January 1, 2010	\$-
Issuances in derivative value due to new security issuances of notes	319,617
Change in fair market value of derivative liabilities	14,861
Beginning balance January 1, 2011	\$334,478
Issuances in derivative value due to new security issuances of notes	149,197
Issuances in derivative value due to new security issuances of common stock and warrants	1,185,150
Conversion of bridge notes into common stock and warrants	(143,961 )
Change in fair market value of derivative liabilities	48,995
Beginning balance January 1, 2012	\$1,573,859
Issuances in derivative value due to new security issuances of notes	2,733,412
Issuances in derivative value due to vesting of non-employee warrants	422,738
Adjustment to derivative liability due to debt repayment	(181,646 )
Adjustment to derivative liability due to debt conversion	(1,020,859)
Change in fair market value of derivative liabilities	(616,728 )
Ending balance June 30, 2012	\$2,910,776

## Key inputs and assumptions:

For issuances of notes, common stock and warrants:

Stock prices on all measurement dates were based on the fair market value

Down round protection is based on the subsequent issuance of common stock at prices less than \$1.50 per share and warrants less than \$2.00 per share

The probability of future financing was estimated at 100%

Computed volatility of 65%

Risk free rates ranging from 0.03% to 0.78%

For issuances of non-employee warrants:

Computed volatility of 65% to 73%

Risk free rates ranging from 0.30% to 1.04%

Expected life (years) from 3.00 to 6.00

See note 9, discussing fair value measurements.

## 6. Bridge Financing, Notes Payable, Accrued Interest and Cash Payment Obligation

## Bridge Financing

From November 2010 through March 2011, the Company issued to a number of accredited investors a series of its 10% Senior Secured Convertible Bridge Note (the "Notes") in the aggregate principal amount of \$1,010,000 (the "Financing"). The Notes accrue interest at the rate of 10% per annum. The entire principal amount evidenced by the Notes (the "Principal Amount") plus all accrued and unpaid interest is due on the earlier of (i) the date the Company completes a financing transaction for the offer and sale of shares of common stock (including securities convertible into or exercisable for its common stock), in an aggregate amount of no less than 125% of the principal amounts evidenced by the Notes (a "Qualifying Financing"), and (ii) November 2 2011. If the Notes are held to maturity, the Company pays, at the option of the holder: i) cash or ii) in securities to be issued by the Company in the Qualifying Financing at the same price paid by other investors. The Notes are secured by a first priority lien and security interest

in all of the Company's assets.

In November 2011, the Company entered into agreements with all holders of the then outstanding Notes. Under the terms of the agreements, holders of Notes totaling \$800,000 agreed to extend the maturity due date of the Notes to February 2, 2012. For these note holders, no change occurred in their rights. Holders of the balance of the Notes totaling \$210,000 agreed to convert the entire principal amount plus all accrued and unpaid interest of \$20,271 into units (each, a "Unit"), each of which consists of one share of common stock of the Company and a four-year warrant to purchase one share of the Company's common stock at \$2.00 per share. The conversion took place at a price of \$1.50 per Unit. Accordingly, the Company issued an aggregate of 153,515 shares of common stock and 153,515 warrants. As a result of the conversion, the holders of the converted Notes forfeited all rights there under, including the right to acquire warrants to purchase the Company's common stock.

Also in November 2011, the Company issued additional Notes in the aggregate principal amount of \$262,500. These Notes were due February 2, 2012 and contain the same rights and privileges as the previously issued Notes. In January, 2012, the Company issued additional Notes in the principal amount of \$520,000. As of April 11, 2012, all note holders with maturity dates of February 2, 2012 extended the maturity through May 2, 2012.

Table of Contents

In March and April 2012, the Company issued additional Notes in the aggregate principal amount of \$220,100 due May 2, 2012. In March 2012, one note holder was repaid a partial principal balance of \$65,000.

In May and June 2012, the Company issued to a number of accredited investors its 10% Senior Secured Convertible Promissory Notes in the principal amount of \$4,347,419 (the "New Notes"), consisting of (i) \$2,656,250 of new funds and (ii) \$1,691,168 principal amount plus accrued but unpaid interest outstanding under previously issued 10% Senior Secured Convertible Bridge Notes (the "Old Notes") that were cancelled and converted into the New Notes. The New Notes accrue interest at the rate of 10% per annum. The entire principal amount under the New Notes (the "Principal Amount") plus all accrued and unpaid interest is due on the earlier of (i) the date the Company completes a financing transaction for the offer and sale of shares of common stock (including securities convertible into or exercisable for its common stock), in an aggregate amount of no less than 125% of the principal amounts evidenced by the Notes (a "Qualifying Financing"), and (ii) October 15, 2012. Payments may be made in cash, or, at the option of the holder of the New Notes in securities to be issued by the Company in the Qualifying Financing at the same price paid for such securities by other investors. The New Notes are secured by a first priority lien and security interest in all of the Company's assets.

The Company will also issue to the holders of the New Notes on the date that is the earlier of the repayment of the New Notes or the completion of the Qualifying Financing, at their option:

- five year warrants (the "Warrants") to purchase that number of shares of Common Stock equal to the Principal Amount plus all accrued and unpaid interest divided by the per share purchase price of the Common stock offered and sold in the Qualifying Financing (the "Offering Price") which Warrants shall be exercisable at the Offering Price and shall include cashless exercise provisions commencing 18 months from the date of issuance of the Warrants if there is not at that time an effective registration statement covering the shares of Common Stock exercisable upon exercise of the Warrants, or
- that number of shares of Common Stock equal to the product arrived at by multiplying (x) the Principal Amount plus all accrued and unpaid interest divided by the Offering Price and (y) 0.33

The Company has granted piggy-back registration rights with respect to the securities to be issued in connection with the New Notes.

The New Notes contain embedded derivatives that on their inception date were valued with a Monte Carlo simulation as discussed in Note 6. The embedded derivatives, as they represent additional consideration given to the New Notes holders, were treated as a discount on the debt that is being amortized over the life of the New Notes which ends on October 15, 2012. The debt discounts booked as reductions to the New Notes during May 2012 were \$478,544 and \$1,852,713 for the variable maturity conversion option and the additional security issuance derivative. During the months of May and June 2012, \$553,616 was amortized from the debt discount into interest expense. The remaining debt discount amounts as of June 30, 2012 are \$364,867 and \$1,412,774, respectively, and will be amortized during the subsequent life ending on October 15, 2012.

The New Notes further provide that in the event of a change of control transaction, the proceeds from such transaction must be used by the Company to pay to the holders of the New Notes, pro rata based on the amount of New Notes owned by each holder, an amount equal to 1.5 times the amount of the aggregate principal amount outstanding under the New Notes, plus all accrued and unpaid interest due there under, plus all other fees, costs or other charges due there under.

The holders of the New Notes were also granted the right to appoint two designees to serve as members of the Company's board of directors, which members will also serve as members of the Compensation Committee and the

Audit Committee of the Company's board of directors.

The Company used \$201,322 from the proceeds of the sale of the New Notes to pay off existing balances under the Old Notes that were not cancelled and converted into the New Notes.

The Company's obligations under the Notes are secured by all of the assets of the Company, including all shares of CommerceTel, Inc., its wholly owned subsidiary.

The Company paid \$200,630 in placement agent fees in connection with the sale and issuance of the New Notes. WFG Investments, Inc. and Emerging Growth Equities, Ltd., both registered broker dealers, cumulatively have been paid placement agent fees related to the Notes in the amount of \$40,000 and \$252,737, respectively, which were capitalized as deferred financing costs, and are being amortized over the term of the Notes using the effective interest method. The Company recorded deferred financing amortization expense for the three months ended June 30, 2012 and 2011, totaling \$65,703 and \$20,000, respectively. The Company also recorded deferred financing amortization expense for the six months ended June 30, 2012 and 2011, totaling \$100,857 and \$20,000, respectively.

Table of Contents

The following table summarizes information relative to all of the outstanding Notes at June 30, 2012 and December 31, 2011:

	June 30, 2012	December 31, 2011
Bridge notes payable	\$ 4,347,419	\$ 1,062,500
Less unamortized discounts:		
Variable maturity discount	(364,867 )	(12,031 )
Warrant discount	(1,412,774 )	(47,739 )
Bridge notes payable, net of discounts	\$ 2,569,778	\$ 1,002,730

In accordance with ASC 470-20 Debt with Conversion and Other Options, the Company recorded a discount of \$560,662 for the variable conversion feature and a discount of \$2,172,750 for the warrants / shares to be issued. The discounts will be amortized to interest expense over the term of the Notes using the effective interest method. The Company recorded \$1,015,541 of interest expense for the amortization of the note discounts associated with derivative liabilities during the year ended June 30, 2012.

In accordance with ASC 815-15, the Company determined that the variable conversion feature and the warrants / shares to be issued represented embedded derivative features, and these are shown as derivative liabilities on the balance sheet. See Note 5.

The Company calculated the fair value of the compound embedded derivatives associated with the convertible notes payable utilizing a complex, customized Monte Carlo simulation model suitable to value path dependant American options. The model uses the risk neutral methodology adapted to value corporate securities. This model utilized subjective and theoretical assumptions that can materially affect fair values from period to period.

#### Mobivity Note

As partial consideration for the acquisition of Mobivity, the Company issued a secured subordinated promissory note in the principal amount of \$606,000. The promissory note accrues interest at 6.25% per annum; is payable in six quarterly installments of \$105,526 (inclusive of interest) starting May 1, 2011; matures on August 1, 2012; is secured by the acquired assets of the Mobivity business; and is subordinated to the Company's obligations under its Notes discussed above. Mobivity, LLC was granted a security interest in the acquired assets, subordinated only to the Company's Notes, and a majority of the Bridge Financing lenders consented to the junior security interest. On May 18, 2012 and May 25, 2012, late payment penalties were paid in the amount of 235,441 common shares valued at \$160,468 based on the closing market price on the date granted; which were expensed through share based compensation.

During the six months ended June 30, 2012, the Company made principal and interest payments totaling \$316,579 on the promissory note, and the note was paid in full on May 31, 2012.

#### Digimark, LLC Notes

As partial consideration for the acquisition of Boomtext, the Company issued a secured subordinated promissory note in the principal amount of \$175,000. The promissory note accrues interest at 6.25% per annum; is payable in full on May 25, 2012 (original maturity March 31, 2012 was extended); is secured by all of the assets of CommerceTel, Inc. and is subordinated to the Company's obligations under its Notes discussed above.

During the six months ended June 30, 2012, the Company made principal and interest payments totaling \$184,266 on the promissory note, and the note was paid in full on May 31, 2012.

As partial consideration for the acquisition of Boomtext, the Company also issued an unsecured subordinated promissory note in the principal amount of \$195,000. The promissory note does not bear interest; is payable in installments (varying in amount) from August 2011 through October 2012; and is subordinated to the Company's obligations under its Notes discussed above. The \$195,000 unsecured subordinated promissory note does not bear interest; accordingly, the Company recorded the promissory note at the present value of the \$195,000 payments over the subsequent periods. The Company used a discount rate of 6.25% in calculating the net present value of the unsecured promissory note. The discount rate was based on the Company's estimated cost of debt capital. Under the effective interest method, the Company accretes the debt discount to the face amount of the promissory note. Accretion of the debt discount totaled \$4,422 for the six months ended June 30, 2012. Accretion of the debt discount was charged to interest expense in accordance with FASB ASC 480.

Table of Contents

## Summary of Notes Payable and Accrued Interest

The following table summarizes the Company's notes payable and accrued interest as of June 30, 2012 and December 31, 2011:

	Notes Payable		Accrued Interest	
	6/30/2012	12/31/2011	6/30/2012	12/31/2011
Bridge notes, net, as discussed above	\$2,569,778	\$1,002,730	\$42,416	\$95,823
Mobivity note, as discussed above	-	310,135	-	-
Unsecured (as amended) note payable due to our Company's former Chief Executive Officer, interest accrues at the rate of 9% compounded annually, all amounts due and payable December 31, 2008, See Note 12	20,000	20,000	12,282	10,871
Note payable due to a trust, interest accrues at the rate of 10% per annum, all amounts due and payable December 31, 2006. The Company is negotiating the terms of this note.	51,984	51,984	21,677	19,084
Digimark, LLC secured subordinated promissory note, as discussed above	-	175,000	-	4,648
Digimark, LLC subordinated promissory note, net, as discussed above	145,241	179,151	-	-
	\$2,787,003	\$1,739,000	\$76,375	\$130,426

Interest expense, including amortization of note discounts, totaled \$880,321 and \$138,258 for the three months ended June 30, 2012 and 2011, respectively. Interest expense, including amortization of note discounts, totaled \$1,238,499 and \$243,666 for the six months ended June 30, 2012 and 2011, respectively.

## Cash Payment Obligation

As partial consideration for the acquisition of Txtstation, the Company agreed to a \$250,000 of scheduled cash payments. The \$250,000 of scheduled cash payments is due as follows: \$25,000 payable on the 60th day following closing and the balance is payable in \$25,000 installments at the end of each of the next nine 30-day periods thereafter. The \$250,000 cash payment obligation does not bear interest; accordingly, the Company recorded the cash payment obligation at the present value of the \$250,000 payments over the subsequent periods. The Company used a discount rate of 6.25% in calculating the net present value of the cash payment obligation. The discount rate was based on the Company's estimated cost of debt capital. Under the effective interest method, the Company accretes the debt discount to the face amount of the promissory note. Accretion of the debt discount totaled \$786 for the six months ended June 30, 2012. Accretion of the debt discount was charged to interest expense in accordance with FASB ASC 480.

During the six months ended June 30, 2012, the Company made payments totaling \$87,500 on the cash payment obligation, and the obligation was paid in full on April 11, 2012

## 7. Stockholders' Equity (Deficit)



Common Stock

On March 2, 2012, the Company issued 150,000 common stock shares at a price of \$1.22 per share totaling \$183,000 for consulting services. The shares were valued based on the closing stock price for the date granted.

On February 1, 2012, the Company authorized 75,000 common stock shares at a price of \$1.16 per share totaling \$87,000 for investor relations consulting services. In May 2012 the Company issued the common stock shares which were valued based on the closing stock price for the date granted.

On May 18, 2012, the Company issued 86,812 common stock shares at a price of \$0.65 per share totaling \$56,428 in share based compensation. The issuance was pursuant to the Mobivity Acquisition Agreement Amendment #1 to the Secured Subordinated Promissory Note and due to the default on the Mobivity Note for the May 18th, 2012 extended quarterly payment. The shares were valued based on the closing stock price for the date granted and constituted a late penalty payment to the note holder; not a principal or interest repayment.

Table of Contents

On May 25, 2012, the Company issued 148,629 common stock shares at a price of \$0.70 per share totaling \$104,040 in share based compensation. The issuance was pursuant to the Mobivity Acquisition Agreement Amendment #1 to the Secured Subordinated Promissory Note and due to the default on the Mobivity Note for the May 25th, 2012 penalty for failure to prepay final payment. The shares were valued based on the closing stock price for the date granted and constituted a late penalty payment to the note holder; not a principal or interest repayment.

As of June 30, 2012, the Company has 23,214,749 common shares outstanding.

## Stock-based Compensation

## 2010 Incentive Stock Option Plan

On December 24, 2010, the Company adopted the 2010 Incentive Stock Option Plan (“the 2010 Plan”), subject to shareholder approval within one year. Shareholder approval was not obtained within one year, therefore incentive stock options granted under the 2010 Plan converted to non-qualified stock options. The 2010 Plan permits the Company to grant up to 3,124,000 shares of common stock and options to purchase shares of common stock. The 2010 Plan is designed to retain directors, executives and selected employees and consultants and reward them for making major contributions to the success of the Company. These objectives are accomplished by making long-term incentive awards under the 2010 Plan thereby providing participants with a proprietary interest in the growth and performance of the Company.

The Company believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price that equals the fair market value of the Company's stock at the date of grant. These option awards generally vest based on four years of continuous service and have five-year or 10-year contractual terms.

A summary of option activity under the 2010 Plan as of June 30, 2012 and changes during the six months then ended is presented below:

	Number Outstanding	Weighted - Average Exercise Price Per Share	Weighted - Average Remaining Contractual Life (Years)
Outstanding at January 1, 2012	1,610,000	\$0.82	4.63
Granted	367,500	0.70	4.94
Exercised	-	-	-
Canceled/forfeited/expired	(187,814 )	0.32	3.48
Outstanding at June 30, 2012	1,789,686	\$0.85	4.81
Options vested and exercisable at June 30, 2012	557,803	\$0.76	4.63

## Expense Information

The Company measures and recognizes compensation expense for all stock-based payment awards made to employees and directors based upon estimated fair values. The Company recorded stock-based compensation in operating expenses for employees totaling \$96,568 and \$138,258 for the three months ended June 30, 2012 and 2011, respectively. The Company also recorded stock-based compensation in operating expenses for employees totaling \$210,429 and \$243,666 for the six months ended June 30, 2012 and 2011, respectively.

## Valuation Assumptions

The Company uses the Black-Scholes option pricing model in determining its option expense. The weighted-average estimated fair value of employee stock options granted during the six months ended June 30, 2012 was \$0.70 per share. There were 367,500 options granted during the six months ended June 30, 2012. The ranges of assumptions used during the six months ended June 30, 2012 are as follows:

	Employee Options
Expected volatility	65% to 73.4%
Risk-free interest rate	0.39% to 0.51%
Forfeiture rate	0.0 %
Expected dividend rate	0.0 %
Expected life(yrs)	3.00 to 4.00

Table of Contents

The expected volatility is based on the weighted average of the historical volatility of publicly traded surrogates in the Company's peer group.

The risk-free interest rate assumption is based upon published interest rates appropriate for the expected life of the Company's employee stock options.

The dividend yield assumption is based on the Company's history of not paying dividends and no future expectations of dividend payouts.

The expected life of the stock options represents the weighted-average period that the stock options are expected to remain outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of its stock-based awards.

## Warrants

During the six months ended June 30, 2012, the Company issued warrants totaling 25,000 to non-employee consultants that include graded vesting terms. As of June 30, 2012, 518,120 warrants were vested pursuant to four non-employee warrant agreements; three of which were granted during the prior year. These warrants were valued using a Monte Carlo Simulation; the fair values of the warrants were estimated at the vesting date and are revalued at each subsequent reporting date. At June 30, 2012, the Company recorded current derivative liabilities for the non-employee warrants totaling \$224,840. The change in fair value of the derivative liabilities for the six months ended June 30, 2012 was a gain of \$197,898, which was reported as other income/(expense) in the consolidated statements of operations.

## Valuation Assumptions

The Company uses a Monte Carlo simulation in determining the fair values of the warrants. There were 25,000 warrants granted during the six months ended June 30, 2012. The Company periodically revalues these warrants as they vest. The ranges of assumptions used during the six months ended June 30, 2012 are as follows:

	Non-Employee Warrants
Expected volatility	65% to 73.4%
Risk-free interest rate	0.30% to 1.04%
Forfeiture rate	0.0 %
Expected dividend rate	0.0 %
Expected life(yrs)	3.00 to 6.00

A summary of non-employee warrant activity during the six months ended and as of June 30, 2012 is presented below:

	Number Outstanding	Weighted - Average Exercise Price Per Share	Weighted - Average Remaining Contractual Life (Years)
Outstanding at January 1, 2012	905,000	\$0.33	4.60
Granted	25,000	1.16	4.59

Exercised	-	-	-
Canceled/forfeited/expired	-	-	-
Outstanding at June 30, 2012	930,000	\$0.35	4.60
Warrants vested and exercisable at June 30, 2012	518,120	\$0.34	4.20

As discussed in Note 6, the Company is obligated to issue warrants or shares pursuant to its Bridge Financing. The number of warrants / shares issuable pursuant to the agreements is not known as of June 30, 2012.

Table of Contents

During the year ended December 31, 2011, the Company issued warrants for the purchase of 688,669 shares of common stock at \$2.00 per share in connection with its private placement discussed above under Common Stock. The warrants are exercisable for four years from the date of issuance, and contain anti-dilution, or down round, price protection as long as the warrant remains outstanding. In addition, the Company issued warrants for the purchase of 153,515 shares of common stock at \$2.00 per share in connection with the conversion of its outstanding Notes with a principal amount of \$210,000 discussed above in Note 6 under Bridge Financing. The warrants are exercisable for four years from the date of issuance. During the six months ended June 30, 2012, the Company did not issue any additional warrants. These warrants are shown below. These warrants are included in the "Common Stock and Warrants" derivative value (see Note 5) as of June 30, 2012 and December 31, 2011.

Beginning balance January 1, 2012	842,184
Warrants issued	-
Warrants exercised	-
Warrants expired	-
Ending balance June 30, 2012	842,184

## 8. Income Taxes

The Company maintains deferred tax assets that reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. These deferred tax assets include net operating loss carry forwards, deferred revenue and stock-based compensation. In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible. The Company considers projected future taxable income and planning strategies in making this assessment. Based on the level of historical operating results and projections for the taxable income for the future, the Company has determined that it is more likely than not that the deferred tax assets will not be realized. Accordingly, the Company has recorded a valuation allowance to reduce deferred tax assets to zero. There can be no assurance that the Company will ever be able to realize the benefit of some or all of the federal and state loss carry forwards, either due to ongoing operating losses or due to ownership changes, which limit the usefulness of the loss carry forwards.

The Company has determined that during 2010 it experienced a "change of ownership" as defined by Section 382 of the Internal Revenue Code. As such, utilization of net operating loss carry forwards and credits generated before the 2010 change in ownership will be limited to approximately \$207,000 per year until such carry forwards are fully utilized. The pre-change net operating loss carry forward was approximately \$7,000,000.

## 9. Fair Value Measurements

Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the authoritative guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the Company to develop its own assumptions. This hierarchy requires companies to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. On a recurring basis, the Company measures certain financial assets and liabilities at fair value, including its derivative liabilities.

At June 30, 2012 and December 31, 2011, the Company recorded a liability related to the variable maturity feature and the future issuance of warrants / shares in connection with its Bridge Notes (See Note 6), and the common stock and warrants issued in the current year (See Note 5) at the aggregate fair market value of \$2,910,776 and \$1,573,859, respectively, utilizing unobservable inputs. The change in fair market value of these liabilities is included in other income (expense) in the consolidated statements of operations. The assumptions used in the Monte-Carlo simulation used to value the derivative liabilities involve expected volatility in the Company's common stock, estimated probabilities related to the occurrence of a future financing, and interest rates. As all the assumptions employed to measure this liability are based on management's judgment using internal and external data, this fair value determination is classified in Level 3 of the valuation hierarchy.

See Note 5 for a table that provides a reconciliation of the beginning and ending balances of the derivative liabilities as of June 30, 2012 and December 31, 2011.

10. Concentrations

During the six months ended June 30, 2012, no customer accounted for more than 10% of revenues. During the six months ended June 30, 2011, one customer accounted for 12% of revenues. At June 30, 2012 one customer accounted for 19% of accounts receivable, this customer's balance is fully reserved in the allowance for doubtful accounts. At December 31, 2011, no customers were greater than 10% of receivables.

Table of Contents

## 11. Commitments and Contingencies

## Earn-Out Contingency

The Company has an earn-out commitment associated with the acquisition of Boomtext from Digimark, LLC. An earn-out payment (payable 20 months after closing of the transaction) of a number of shares of common stock of the Company equal to (a) 1.5, multiplied by the Company's net revenue from acquired customers and customer prospects for the twelve-month period beginning six months after the closing date, divided by (b) the average of the volume-weighted average trading prices of the Company's common stock for the 25 trading days immediately preceding the earn-out payment (subject to a collar of \$1.49 and \$2.01 per share). As of June 30, 2012, and December 31, 2011, the estimated dollar value of the earn-out payable is \$2,581,456, and \$2,658,238, respectively. As of June 30, 2012 this was recorded as a current liability and was recorded as a non-current liability as of December 31, 2011 on the accompanying consolidated balance sheet.

## Litigation

On June 23, 2012, the Company initiated litigation against a former client (the "Defendant") for failure to pay the Company's invoices for services rendered under its Master License and Services Agreement. The complaint was filed in Superior Court of California, San Diego County. The litigation seeks to recover \$67,795 in services and interest penalties. As of August 9, 2012, the Defendant has not responded to the complaint.

## Operating Lease

On February 28, 2012, the Company signed an amendment to its existing lease for the facility in Chandler, Arizona to expand by adding 2,519 square feet in an adjacent suite. The amended lease agreement remains in force through December 2015.

The minimum lease payments required over the next five years is shown below as of June 30, 2012.

## Minimum Lease Payments

2012	\$	65,100
2013		138,678
2014		143,492
2015		148,281
2016		-
	\$	495,551

## Lease Exit Obligation

The Company had a lease agreement for its office facilities in San Diego, California through June 2012. Upon signing a lease agreement for the facility in Chandler, the Company determined it no longer needed the San Diego facility. The property was vacated in November 2011 and returned to the owner. As of June 30, 2012, the Company has a Lease Exit Obligation totaling \$71,481 for the period December 2011 through June 2012, made up of, \$38,088 in remaining rent obligation, \$32,550 in remaining deferred rent, and \$843 in estimated common area maintenance charges. The Company expects no further charges in relation to this lease exit obligation, aside from actual common area maintenance charges reconciled against the estimate.



Rent expense for both the San Diego, California, and Chandler, Arizona facilities was \$92,617 for the six months ended June 30, 2012, and \$34,043 (for the San Diego location only) for the six months ended June 30, 2011.

12. Employee Benefit Plan

The Company has an employee savings plan (the "Plan") pursuant to Section 401(k) of the Internal Revenue Code (the "Code"), covering all of its employees. Participants in the Plan may contribute a percentage of compensation, but not in excess of the maximum allowed under the Code. The Company may make contributions at the discretion of its Board of Directors. During the six months ended June 30, 2012 and 2011, the Company made no contributions to the Plan.

Table of Contents

13. Related Party Transactions

Prior to the reverse merger on November 2, 2010, Optimal Payments Corporation converted \$570,534 of debt into \$370,534 worth of Commercetel Inc common stock and \$200,000 of prepaid services to be rendered by CommerceTel. These services remain owed to Optimal Payments Corporation at December 31, 2011. A member of CommerceTel's Board of Directors is currently President of Sterling Card Solutions, which has a minority ownership position in Optimal Payments Corporation. During the six months ended June 30, 2012, the Company began work on a project for Optimal Payments Corporation and recognized revenue of \$84,000.

Hidden River Ventures I, LLC is an existing shareholder in CommerceTel Corporation as a result of converting \$229,000 of payables in exchange for 415,937 shares of CommerceTel Corporation common stock. On October 26, 2010, the Company entered into a consulting agreement with a related company under common control, Hidden River, LLC, pursuant to which Hidden River, LLC would lead the Company's acquisition strategy. The consulting agreement calls for monthly payments of \$10,000, along with periodic bonus payments associated with the success of the acquisition strategy, as well as options to purchase 700,000 shares granted on December 24, 2010 priced at \$.32 per share. Of the options granted, 437,495 options were vested as of June 24, 2012. For the six months ended June 30, 2012, Hidden River earned \$60,000.

During the year ended December 31, 2011, the company entered into an employment agreement with the primary owner and shareholder of Digimark LLC, holder of 519,540 common shares, to serve as Executive Vice President of Business Development. He was paid \$60,000 as of June 30, 2012.

14. Subsequent Events

Employment Agreement, Chief Financial Officer

Effective as of August 1, 2012, the Company entered into an employment agreement (the "Agreement") with Tim Schatz, the Company's Chief Financial Officer. The Agreement has an initial term of three years. Unless terminated at least 90 days prior to the expiration date by either party, the Agreement automatically renews for additional one-year periods.

Under the terms of the Agreement, Mr. Schatz will be paid a base salary of \$160,000 per annum. A onetime bonus of \$2,917 was paid upon signing. The base salary may be increased based on an annual salary review by the Company's Board of Directors, commencing on December 31, 2012, and each 12 month period thereafter. The Company's Board may also award an annual bonus of up to 30% of the base salary for achieving milestones as defined by the Board from time to time.

Mr. Schatz will also be granted options to purchase 225,000 shares of common stock of the Company pursuant to the terms and conditions of the Company's incentive stock option plan, if and when adopted by the Company. Awards there under will be made from time to time at the discretion of the Board.

Amendment to Articles of Incorporation, Corporate Name Change

On August 6, 2012, the Company filed a document with the Secretary of State of the State of Nevada changing its corporate to Mobivity Holdings Corp. The name change will be effectuated by merging the Company's wholly owned subsidiary into itself without shareholder approval, as permitted by Nevada law. The name change will become effective on August 22, 2012, which the Company expects is the date that the FINRA will announce the name change.

15. Restatement

On or about March 26, 2012, management and the Company concluded that the Company should restate goodwill related charges in connection with its three acquisitions that were completed during the year ended December 31, 2011. The Company's method of valuing the restricted common stock issued in the acquisitions at the price paid by investors for Company shares in a number of private offerings around the time of the acquisitions was incorrect, and a revised discounted restricted common stock valuation be used, as required under FAS 157/ASC 820. This change in valuation method of securities also affected share based compensation expense and certain derivative liabilities and related expenses.

Under ASC 820 Fair Value Measurements & Disclosures, a quoted stock price in an active market is considered primary (Type I) indicator of fair value of restricted stock issued in consideration for the acquisitions completed in 2011. The Company believed that the infrequent and low volume of initial trading of its common stock did not constitute an active market. Alternatively, throughout the year the company conducted a private placement in which units comprised of shares of restricted common stock and attached warrants were sold at \$1.50 per share. This price per share was bifurcated for the value of the common stock, the warrant, an embedded derivative related to down round protection on common stock, and an embedded derivative related to down round protection on the warrant. The price per common share that was determined by this valuation equaled \$1.05 for the three months ended June 30, 2011. The use of this method resulted in understated asset value for certain intangible assets, understated stock based compensation expense, an understatement of certain derivative liabilities and an understatement of the related expense related to the Company's derivative liability, as reflected in its financial statements for the quarter ended June 30, 2011.

The cumulative effect of this change through June 30, 2011 is an increase of \$7,067,000 in goodwill, an increase of \$32,143 in intangible assets, an increase of \$590,860 in current liabilities, an increase of \$7,623,382 in additional paid-in capital, and a decrease of \$1,115,100 in the Company's net income; however, this had no effect on the Company's reported cash flows. Unaudited Tables detailing the effect of the error on the Company's previously filed financial statements for the quarter ended June 30, 2011 are included below.

Table of ContentsNOTE 15 - RESTATEMENT OF FINANCIAL STATEMENTS  
(CONTINUED)

## Balance Sheet

	As Filed	June 30, 2011 Adjustments	Restated
<b>Current Assets</b>			
Cash	\$ 23,195	\$ -	\$ 23,195
Accounts Receivable	154,978	-	154,978
Other Current Assets	43,852	-	43,852
Total Current Assets	222,025	-	222,025
Equipment, Net	31,865	-	31,865
Goodwill	1,996,763	7,067,000 (a)	9,063,763
Intangible Assets, Net	2,319,240	32,143 (a)	2,351,383
Other Assets	67,750	-	67,750
<b>TOTAL ASSETS</b>	<b>\$ 4,637,643</b>	<b>\$ 7,099,143</b>	<b>\$ 11,736,786</b>
<b>Current Liabilities</b>			
Accounts Payable	\$ 304,088	\$ -	\$ 304,088
Accrued Interest	91,628	-	91,628
Accrued and Deferred Personnel Compensation	127,802	-	127,802
Deferred Revenue - related party	200,000	-	200,000
Deferred Revenue and Customer Deposits	143,639	-	143,639
Notes Payable, net of discount	580,895	-	580,895
Convertible notes payable, net of discount	867,111	(2,944 ) (a)	864,167
Cash payment obligation, net of discount	219,424	-	219,424
Derivative Liabilities	329,479	593,804 (a)	923,283
Other Current Liabilities	98,488	-	98,488
Total Current Liabilities	2,962,554	590,860	3,553,414
<b>Non-Current Liabilities</b>			
Notes Payable	31,807	-	31,807
Total Non-Current Liabilities	31,807	-	31,807
Total Liabilities	2,994,361	590,860	3,585,221
<b>Stockholders' Deficit</b>			
Common Stock, \$0.001 par value; 150,000,000 shares authorized; 21,509,620 and 17,700,000 shares			

issued and outstanding as of  
June 30, 2011 and

December 31, 2010, respectively	21,509	-	21,509
Additional Paid-in Capital	10,990,429	7,623,382 (a)	18,613,811
Accumulated Deficit	(9,368,656 )	(1,115,100 ) (a)	(10,483,756)
Total Stockholders' Deficit	1,643,282	6,508,283	8,151,565
<b>TOTAL LIABILITIES &amp; STOCKHOLDERS' DEFICIT</b>	<b>\$ 4,637,643</b>	<b>\$ 7,099,143</b>	<b>\$ 11,736,786</b>

(a) To reflect change due to the change in fair market value of restricted stock in underlying calculations

Table of ContentsNOTE 15 - RESTATEMENT OF FINANCIAL STATEMENTS  
(CONTINUED)

## Statement of Operations

	Three months ended June 30, 2011		
	As Filed	Adjustments	Restated
<b>Revenues</b>			
Revenues	\$ 553,108	\$ -	\$ 553,108
Cost of revenues	179,051	-	179,051
Gross Margin	374,057	-	374,057
<b>Operating Expenses</b>			
General & administrative	374,448	185,187 (a)	559,635
Sales & marketing expense	200,822	15,263 (a)	216,085
Engineering, research, & development expense	161,291	17,982 (a)	179,273
Depreciation & amortization	124,741	-	124,741
Total Operating Expenses	861,302	218,432	1,079,734
Loss From Operations	(487,245 )	(218,432 )	(705,677 )
<b>Other Income/(Expense)</b>			
Interest income	16	-	16
Interest expense	(138,258 )	-	(138,258 )
Change in fair market value of derivative liabilities	159,263	(313,367 ) (a)	(154,104 )
Total Other Income/(Expense)	21,021	(313,367 )	(292,346 )
Loss before income taxes	(466,224 )	(531,799 )	(998,023 )
Income tax benefit/(expense)	38	-	38
Net Loss	\$ (466,186 )	\$ (531,799 )	\$ (997,985 )
Net Loss Per Share - Basic and Diluted	\$ (0.02 )	\$ (0.02 ) (a)	\$ (0.05 )
<b>Weighted average number of shares</b>			
during the period - basic and diluted	21,336,579	21,336,579	21,336,579

NOTE 15 - RESTATEMENT OF FINANCIAL STATEMENTS  
(CONTINUED)

## Statement of Operations

	Six months ended June 30, 2011		
	As Filed	Adjustments	Restated
<b>Revenues</b>			
Revenues	\$ 693,745	\$ -	\$ 693,746
Cost of revenues	258,888	-	258,888
Gross Margin	434,857	-	434,858
<b>Operating Expenses</b>			
General & administrative	920,443	263,406 (a)	1,183,849
Sales & marketing expense	255,679	24,331 (a)	280,010
Engineering, research, & development expense	289,862	35,902 (a)	325,764
Depreciation & amortization	126,778	-	126,778
Total Operating Expenses	1,592,762	323,639	1,916,401
Loss From Operations	(1,157,905 )	(323,639 )	(1,481,543 )
<b>Other Income/(Expense)</b>			
Interest income	174	-	174
Interest expense	(243,666 )	-	(243,666 )
Change in fair market value of derivative liabilities	206,956	(791,462 ) (a)	(584,506 )
Total Other Income/(Expense)	(36,536 )	(791,462 )	(827,998 )
Loss before income taxes	(1,194,441 )	(1,115,100 )	(2,309,541 )
Income tax benefit/(expense)	38	-	38
Net Loss	\$ (1,194,403 )	\$ (1,115,100 )	\$ (2,309,503 )
Net Loss Per Share - Basic and Diluted	\$ (0.06 )	\$ (0.06 ) (a)	\$ (0.12 )
<b>Weighted average number of shares</b>			
during the period - basic and diluted	19,534,081	19,534,081	19,534,081

(a) To reflect change due to the change in fair market value of restricted stock in underlying calculations





Table of Contents

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

This Quarterly Report on Form 10-Q contains "forward-looking statements" as defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, in connection with the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially and adversely from those expressed or implied by such forward-looking statements. Such forward-looking statements include statements about our expectations, beliefs or intentions regarding our potential product offerings, business, financial condition, results of operations, strategies or prospects. You can identify forward-looking statements by the fact that these statements do not relate strictly to historical or current matters. Rather, forward-looking statements relate to anticipated or expected events, activities, trends or results as of the date they are made and are often identified by the use of words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," or "will," expressions or variations. Because forward-looking statements relate to matters that have not yet occurred, these statements are inherently subject to risks and uncertainties that could cause our actual results to differ materially from any future results expressed or implied by the forward-looking statements. Many factors could cause our actual activities or results to differ materially from the activities and results anticipated in forward-looking statements. These factors include those described under the caption "Risk Factors" included elsewhere in this Quarterly Report on Form 10-Q and in our other filings with the Securities and Exchange Commission, or the SEC. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of such statements.

Overview

We are a provider of technology that enables major brands and enterprises to engage consumers via their mobile phone. Interactive electronic communications with consumers is a complex process involving communication networks and software. We remove this complexity through our suite of services and technologies thereby enabling brands, marketers, and content owners to communicate with their customers and consumers in general. From Presidential elections to major broadcast events, we are pioneers in the deployment of the mobile channel as the ultimate direct connection to the consumer.

Mobile phone users represent a large and captive audience. While televisions, radios, and even PCs are often shared by multiple consumers, mobile phones are personal devices representing a truly unique and individual address to the end user. The future of digital media will be driven by mobile phones where a direct, personal conversation can be had with the world's largest audience. The future of mobile includes banking, commerce, advertising, video, games and just about every other aspect of both on and offline life. Over 4 million consumers have been engaged via their mobile device thanks to our technology.

We believe that our mobile marketing and advertising campaign platform is among the most advanced in the industry as it allows real time interactive communications with consumers. We generate revenue from licensing our software to clients in our software as a service (SaaS) model, per-message and per-minute transactional fees, and customized professional services.

Our "C4" Mobile Marketing and Customer Relationship Management (CRM) platform is a hosted solution enabling our clients to develop, execute, and manage a variety of engagements to a consumer's mobile phone. Short Messaging Service (SMS), Multi-Media Messaging (MMS), and Interactive Voice Response (IVR) interactions can all be facilitated via a set of Graphical User Interfaces (GUIs). Reporting and analytics capabilities are also available to our users through the C4 solution.

Mobile devices are emerging as the principal interactive channel for brands to reach consumers since it is the only media platform that has access to the consumer virtually anytime and anywhere. Brands and advertising agencies are recognizing the unique benefits of the mobile channel and they are increasingly integrating mobile media within their overall advertising and marketing campaigns. Our objective is to become the industry leader in connecting brands and enterprises to consumers' mobile phones.

## Table of Contents

### Recent Events

#### Share Exchange Agreement

On November 2, 2010, we completed the Share Exchange Agreement and acquired CommerceTel, Inc., in exchange for 10,000,000 shares of our common stock. Please refer to Note 1 in the accompanying condensed consolidated financial statements.

#### Bridge Financing

To date in 2012, we have issued additional 10% Senior Secured Convertible Bridge Notes in the aggregate of \$3,533,999. (See discussion of Bridge Notes in Liquidity and Capital Resources, and Note 6 to Consolidated Financial Statements) As of August 14, 2012 there is \$4,347,419 in principal amount of outstanding notes, which are due October 15, 2012. We are currently working with the note holders to extend the maturity or convert into equity.

To date in 2012, eight note holders were repaid \$249,080 in principal.

#### Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Our management periodically evaluates the estimates and judgments made, including those related to share based compensation and valuation of the derivative liability. Management bases its estimates and judgments on historical experience and on various factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The following critical accounting policies affect the more significant judgments and estimates used in the preparation of the Company's consolidated financial statements.

#### Revenue recognition

The Company's "C4" Mobile Marketing and Customer Relationship Management (CRM) platform is a hosted solution, as is the newly acquired Txtstation Control Center platform. The Company generates revenue from licensing its software to clients in its software as a service (SaaS) model, per-message and per-minute transactional fees, and customized professional services. The Company recognizes license fees over the period of the contract, service fees as the services are performed, and per-message or per-minute transaction revenue when the transaction takes place. The Company recognizes revenue at the time that the services are rendered, the selling price is fixed, and collection is reasonably assured, provided no significant obligations remain. The Company considers authoritative guidance on multiple deliverables in determining whether each deliverable represents a separate unit of accounting. As for the newly acquired Mobivity and Boomtext platforms, which are both hosted solutions, revenue is principally derived from subscription fees from customers. The subscription fee is billed on a month to month basis with no contractual term and is collected by credit card for Mobivity and collected by cash and credit card for Boomtext. Revenue is recognized at the time that the services are rendered and the selling price is fixed with a set range of plans. Cash received in advance of the performance of services is recorded as deferred revenue. Deferred revenues to related parties totaled \$116,000 at June 30, 2012 and \$200,000 at December 31, 2011. Deferred revenues to third parties totaled \$106,665 at June 30, 2012 and \$109,063 at December 31, 2011.



## Table of Contents

### Share-based compensation expense

Share-based compensation cost is measured at the date of grant, based on the calculated fair value of the stock-based award, and is recognized as expense over the employee's requisite service period (generally the vesting period of the award). The Company estimates the fair value of employee stock options granted using the Black-Scholes Option Pricing Model. Key assumptions used to estimate the fair value of stock options include the exercise price of the award, the fair value of the Company's common stock on the date of grant, the expected option term, the risk free interest rate at the date of grant, the expected volatility and the expected annual dividend yield on the Company's common stock. We use comparable public company data among other information to estimate the expected price volatility and the expected forfeiture rate. The Company recorded stock based compensation of \$210,429 and \$596,336 for the six months ended June 30, 2012 and 2011, respectively.

### Derivative Financial Instruments

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks.

The Company reviews the terms of convertible debt and equity instruments it issues to determine whether there are embedded derivative instruments, including the embedded conversion option, that are required to be bifurcated and accounted for separately as a derivative financial instrument. In circumstances where the convertible instrument contains more than one embedded derivative instrument, including the conversion option, that is required to be bifurcated, the bifurcated derivative instruments are accounted for as a single, compound derivative instrument. Also, in connection with the sale of convertible debt and equity instruments, the Company may issue freestanding warrants that may, depending on their terms, be accounted for as derivative instrument liabilities, rather than as equity.

Bifurcated embedded derivatives are initially recorded at fair value and are then revalued at each reporting date with changes in the fair value reported as non-operating income or expense. When the convertible debt or equity instruments contain embedded derivative instruments that are to be bifurcated and accounted for as liabilities, the total proceeds allocated to the convertible host instruments are first allocated to the fair value of all the bifurcated derivative instruments. The remaining proceeds, if any, are then allocated to the convertible instruments themselves, usually resulting in those instruments being recorded at a discount from their face value.

The discount from the face value of the convertible debt, together with the stated interest on the instrument, is amortized over the life of the instrument through periodic charges to income, using the effective interest method.

The fair value of the derivatives is estimated using a Monte Carlo simulation model. The model utilizes a series of inputs and assumptions to arrive at a fair value at the date of inception and each reporting period. Some of the key assumptions include the likelihood of future financing, stock price volatility, and discount rates.

### Results of Operations

The following describes certain line items set forth in our condensed consolidated statements of operations.

#### Comparison of the Three Months Ended June 30, 2012 and 2011

##### Revenues

Revenues for the three months ended June 30, 2012 was \$1,009,398, an increase of \$456,290, or 82% compared to the three months ended June 30, 2011. The increase is primarily attributed to the acquisition of Boomtext on August 1, 2011, which generated additional revenue of \$421,069.



## Table of Contents

### Cost of Revenues

Cost of revenue for the three months ended June 30, 2012 was \$332,458, an increase of \$153,407, or 86% compared to the three months ended June 30, 2011. This increase is mostly due to the Boomtext acquisition and the increased costs for SMS transmission, short code fees, marketing materials, sales commissions, co-location costs, and merchant fees resulting from the acquisition.

### Gross Profit

Gross profit for the three months ended June 30, 2012 was \$676,940, an increase of \$302,883, or 81%, compared to the three months ended June 30, 2011. Gross profit as a percentage of revenue for the three months ended June 30, 2012 decreased to 67% compared to 68% for the three months ended June 30, 2011. The decrease in gross profit as a percentage of revenue is mostly attributed to the Boomtext acquisition and the increased costs for SMS transmission, short code fees, marketing materials, sales commissions, co-location costs, and merchant fees.

### General and Administrative Expense

General and administrative expenses for the three months ended June 30, 2012 and 2011 were \$797,763 and \$559,635, respectively. Such expenses consist primarily of salaries and personnel related expenses, stock-based compensation expense, consulting costs and other expenses. The increase of \$238,128 or 43% was primarily due to an increase in payroll and employee compensation of \$109,587 resulting from our acquisition of Boomtext, bad debt expense of \$26,592, and rent expense of \$25,609.

### Sales and Marketing Expense

Sales & Marketing expenses for the three months ended June 30, 2012 and 2011 were \$381,868 and \$216,085, respectively. Such expenses consist primarily of salaries and personnel related expenses, stock-based compensation expense, sales travel, consulting costs and other expenses. The increase of \$165,783 or 77% was primarily due to an increase in sales and marketing headcount resulting from the Boomtext acquisition and an increase in sales and marketing related travel as compared to 2011.

### Engineering, Research, and Development Expense

Engineering, research, and development expenses for the three months ended June 30, 2012 and 2011 were \$134,780 and \$179,273, respectively. Such expenses consist primarily of salaries and personnel related expenses, stock-based compensation expense, consulting costs and other expenses. The decrease of \$44,493 or 25% was primarily due to a decrease in consulting expense.

### Depreciation and Amortization Expense

Depreciation and amortization expense for the three months ended June 30, 2012 and 2011 were \$146,765 and \$124,741, respectively. The increase of \$22,024 or 18% was primarily due to the amortization expense related to the amortization of intangibles assets acquired in the Boomtext acquisitions.

### Loss from Operations

Loss from operations for the three months ended June 30, 2012 was \$784,236, an increase of \$78,559, or 11%, compared to the three months ended June 30, 2011. The increase can mostly be attributed to an increase in gross profit of \$302,883 which was offset by an increase in operating expense of \$381,442.





## Table of Contents

### Interest Expense

Interest expense for the three months ended June 30, 2012 was \$880,321 an increase of \$742,063 or 537% compared to the three months ended June 30, 2011. The increase is primarily due to an increase in amortization of bridge note financing totaling \$582,343. It is also attributed to an increase in amortization of deferred financing costs totaling \$45,703.

### Change in Fair Value of Derivative Liabilities

The gain on fair value of derivative liabilities for the three months ended June 30, 2012 was \$654,477; whereas during the three months ended June 30, 2011, there was a loss of \$154,104. The increase of \$808,581 is primarily due a lower share price as of June 30, 2012, as compared to the prior year's June 30, 2011 share price.

### Net Loss

Net Losses for the three months ended June 30, 2012 and June 30, 2011 were \$991,545 and \$997,985 respectively. The decrease of \$6,440 or 1.0% can mostly be attributed to an increase in gross profit of \$302,883 and a decrease of \$85,037 in other expense which were offset by an increase in operating expense of \$381,442.

### Comparison of the Six Months Ended June 30, 2012 and 2011

#### Revenues

Revenues for the six months ended June 30, 2012 was \$2,022,604, an increase of \$1,328,858, or 192% compared to the six months ended June 30, 2011. The increase is primarily attributed to the acquisitions of Mobivity and Txtstation on April 1, 2011 and of Boomtext on August 1, 2011.

#### Cost of Revenues

Cost of revenues for the six months ended June 30, 2012 was \$700,228, an increase of \$441,340, or 170% compared to the six months ended June 30, 2011. This increase is mostly due to the Mobivity, Txtstation and Boomtext acquisitions and the increased costs for SMS transmission, short code fees, marketing materials, sales commissions, co-location costs, and merchant fees resulting from the acquisitions.

#### Gross Profit

Gross profit for the six months ended June 30, 2012 was \$1,322,376, an increase of \$887,518, or 204%, compared to the six months ended June 30, 2011. Gross profit as a percentage of revenue for the six months ended June 30, 2012 increased to 65% compared to 63% for the six months ended June 30, 2011. The increase is primarily due to the acquisitions of Mobivity and Txtstation which generate higher gross margins. These increases were offset by the Boomtext acquisition which generates lower gross margins.

#### General and Administrative Expense

General and administrative expenses for the six months ended June 30, 2012 and 2011 were \$1,717,256 and \$1,183,849, respectively. Such expenses consist primarily of salaries and personnel related expenses, stock-based compensation expense, consulting costs and other expenses. The increase of \$533,407 or 45% was primarily due to an increase in payroll and employee compensation of \$217,158 resulting from our acquisition of Boomtext, an increase in stock based compensation expense for consulting services of \$270,000, bad debt expense of \$72,976 and

rent expense of \$58,574. This was offset by a decrease for legal expense of \$67,916 and consulting expense of \$35,950.

-28-

---

## Table of Contents

### Sales and Marketing Expense

Sales & Marketing expenses for the six months ended June 30, 2012 and 2011 were \$729,119 and \$280,010, respectively. Such expenses consist primarily of salaries and personnel related expenses, stock-based compensation expense, sales travel, consulting costs and other expenses. The increase of \$449,109 or 160% was due to an increase in sales and marketing headcount resulting from the acquisition of Boomtext and Txtstation, with an increase in sales and marketing related travel as compared to 2011.

### Engineering, Research, and Development Expense

Engineering, research, and development expenses for the six months ended June 30, 2012 and 2011 were \$293,081 and \$325,764, respectively. Such expenses consist primarily of salaries and personnel related expenses, stock-based compensation expense, consulting costs and other expenses. The decrease of \$32,683 or 10% was primarily due to a decrease in consulting expense.

### Depreciation and Amortization Expense

Depreciation and amortization expense for the six months ended June 30, 2012 and 2011 were \$301,382 and \$126,778, respectively. The increase of \$174,604 or 138% was primarily due to the amortization expense related to the amortization of intangibles assets acquired in the Mobivity, Txtstation and Boomtext acquisitions.

### Loss from Operations

Loss from operations for the six months ended June 30, 2012 was \$1,718,462, an increase of \$236,919, or 16%, compared to the six months ended June 30, 2011. The increase can mostly be attributed to an increase in gross profit of \$887,518 which was more than offset by an increase in operating expense of \$1,124,437.

### Interest Expense

Interest expense for the six months ended June 30, 2012 was \$1,238,499 an increase of \$994,833 or 408% compared to the six months ended June 30, 2011. The increase is primarily due to an increase in amortization of bridge note financing totaling \$856,440. It is also attributed to an increase in amortization of deferred financing costs totaling \$80,857.

### Change in Fair Value of Derivative Liabilities

The gain on fair value of derivative liabilities for the six months ended June 30, 2012 was \$193,990; whereas during the six months ended June 30, 2011, there was a loss of \$584,506. The increase of \$778,496 is primarily due a lower share price as of June 30, 2012, as compared to the prior year's June 30, 2011 share price.

### Net Loss

Net Losses for the six months ended June 30, 2012 and June 30, 2011 were \$2,683,785 and \$2,309,541, respectively. The increase of \$374,244 or 16% can mostly be attributed to an increase in gross profit of \$887,518 which was more than offset by an increase in operating expense of \$1,124,437 and an increase in other expense of \$137,325.

### Liquidity and Capital Resources

As of June 30, 2012 we had current assets of \$2,055,462, including \$1,053,573 in cash, and current liabilities of \$10,162,899. As of December 31, 2011 we had current assets of \$260,166, including \$396 in cash, and current liabilities of \$5,182,219.

Table of Contents

Cash Flows from Operating Activities

Our operating activities resulted in net cash used for operations of \$1,225,514 for the six months ended June 30, 2012 compared to net cash used in operations of \$599,453 for the six months ended June 30, 2011.

The net cash used in operating activities for the six months ended June 30, 2012 reflects a net loss of \$2,683,785, which was increased by bad debt expense \$79,179, common stock for services of \$270,000, stock-based compensation of \$370,897, depreciation and amortization of \$301,382, amortization of deferred financing costs of \$100,857, and amortization of note discounts of \$1,020,749, which was partially offset by a gain on adjustment in contingent consideration of \$76,782, a change in fair market value of derivative liabilities of \$193,990 and other minor factors. For the six months ended June 30, 2012 the non-cash charges totaled \$1,872,455. Changes in operating assets and liabilities included decreases in accounts receivable of (\$110,239), other current assets of (\$540,553) other assets of (\$2,060), accounts payable of (\$189,617), accrued compensation of (\$22,826) and deferred revenue and customer deposits of (\$86,611), offset by increases in accrued interest of \$83,598 and other liabilities of \$454,123.

The net cash used in operating activities for the six months ended June 30, 2011 reflects a net loss of \$2,309,503, which was increased by bad debt expense \$6,203, stock-based compensation of \$596,336, depreciation and amortization of \$126,778, change in fair market value of derivative liabilities of \$584,506, amortization of deferred financing costs of \$20,000 and amortization of note discounts of \$161,565. For the six months ended June 30, 2011 the non-cash charges totaled \$1,495,387. Changes in operating assets and liabilities included increases in accounts payable of \$152,145, accrued interest of \$53,727, deferred revenues and customer deposits of \$90,321, other current assets \$34,362, other liabilities \$29,346, and other minor factors, offset by a decrease in accounts receivable (\$111,966) and other assets (\$41,433).

Cash Flows from Investing Activities

Net cash used in investing activities for the six months ended June 30, 2012 and 2011 was \$9,732 and \$172,340, respectively. In 2012 and 2011 we acquired equipment totaling \$9,732 and \$6,186, respectively. In 2011, we acquired intangible assets (patents and trademarks) totaling \$75,001 and also paid \$91,153 in cash for the acquisition of Txtstation and Mobivity.

Cash Flows from Financing Activities

Net cash provided by financing activities for the six months June 30, 2012 and 2011 was \$2,288,423 and \$421,548, respectively. In 2012, we received proceeds of \$3,396,350 from the issuance of 10% Senior Secured Convertible Bridge Notes, offset by payments of \$247,880 in deferred financing costs. In 2012, we paid \$249,080 against eight \$10% Senior Secured Bridge Notes, payments of \$523,467 against the principal balance of the notes issued in the Mobivity and Boomtext acquisitions, and payments of \$87,500 against the cash payment obligation resulting from the Txtstation acquisition. In 2011, we received proceeds of \$555,501 from the sale of 370,334 shares of common stock and the issuance of warrants to purchase 370,334 shares at \$2.00 per share, offset by equity offering costs of \$21,800. We received \$10,000 from the issuance of a 10% Senior Secured Convertible Bridge Note. In 2011, we paid \$97,153 against the principal balance of the note issued in the Mobivity acquisition as well as \$25,000 against the cash payment obligation from the Txtstation acquisition.

Table of Contents

Bridge Note Financing

We have completed the following bridge note financing:

- From November 2010 through March 2011, the Company issued to a number of accredited investors a series of its 10% Senior Secured Convertible Bridge Note (the “Notes”) in the aggregate principal amount of \$1,010,000. The Notes accrue interest at the rate of 10% per annum.
- In November 2011, the Company entered into agreements with all holders of the then outstanding Notes. Under the terms of the agreements, holders of Notes totaling \$800,000 agreed to extend the maturity due date of the Notes to February 2, 2012. For these note holders, no change occurred in their rights. Holders of the balance of the Notes totaling \$210,000 agreed to convert the entire principal amount plus all accrued and unpaid interest of \$20,271 into units (each, a “Unit”), each of which consists of one share of common stock of the Company at \$1.50 a share and a four-year warrant to purchase one share of the Company’s common stock at \$2.00 per share.
- Also in November 2011, the Company issued additional Notes in the aggregate principal amount of \$262,500. These Notes were due February 2, 2012 and contain the same rights and privileges as the previously issued Notes.
- In January, 2012, the Company issued additional Notes in the principal amount of \$520,000. All note holders with maturity dates of February 2, 2012 extended the maturity through May 2, 2012.
  - In March and April 2012, the Company issued additional Notes in the aggregate principal amount of \$220,100 due May 2, 2012. In March 2012, one note holder was repaid a partial principal balance of \$65,000.
- In May and June 2012, the Company issued to a number of accredited investors its 10% Senior Secured Convertible Promissory Notes in the principal amount of \$4,347,419 (the “New Notes”), consisting of (i) \$2,656,250 of new funds and (ii) \$1,691,168 principal amount plus accrued but unpaid interest outstanding under previously issued 10% Senior Secured Convertible Bridge Notes (the “Old Notes”) that were cancelled and converted into the New Notes. The New Notes accrue interest at the rate of 10% per annum. The entire principal amount under the New Notes (the “Principal Amount”) plus all accrued and unpaid interest is due on the earlier of (i) the date the Company completes a financing transaction for the offer and sale of shares of common stock (including securities convertible into or exercisable for its common stock), in an aggregate amount of no less than 125% of the principal amounts evidenced by the Notes (a “Qualifying Financing”), and (ii) October 15, 2012.
- The Company used \$201,322 from the proceeds of the sale of the New Notes to pay off existing balances under the Old Notes that were not cancelled and converted into the New Notes.
- The Company’s obligations under the New Notes are secured by all of the assets of the Company, including all shares of our wholly owned subsidiary.

Table of Contents

2011 Private Placement

We commenced a private placement in late March 2011, which continued until November 2011, raising gross proceeds of approximately \$1,033,000. The private placement structure consists of a series of identical subscription agreements offering subscribers an opportunity to invest in units comprised of shares of our common stock at a price of \$1.50 per share and an equivalent number of warrants at an exercise price of \$2.00. Both the shares and the warrants are price protected by us. The price protection obligates us to issue to the investors an additional number of shares in the event that common shares are issued at a price below \$1.50 before August 31, 2012.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Recent Accounting Pronouncements

Refer to Note 2, "Summary of Significant Accounting Policies," in the accompanying notes to the condensed consolidated financial statements for a discussion of recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

As a smaller reporting company, as defined by section 10(f)(1) of Regulation S-K, we are not required to provide the information set forth in this item.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, being June 30, 2012, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act") are not effective such that the information relating to CommerceTel, including our consolidating subsidiaries, required to be disclosed by the Company in reports that it files or submits under the Exchange Act (1) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (2) is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Table of Contents

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. The term "internal control over financial reporting" is defined as a process designed by, or under the supervision of, an issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and
- (2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and those receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer.

Under the supervision of our president, being our principal executive officer, and our chief financial officer, being our principal financial officer and principal accounting officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of June 30, 2012 using the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operating effectiveness of controls and a conclusion on this evaluation. Based on this evaluation, our management concluded our internal control over financial reporting was not effective as at June 30, 2012.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our company's annual or interim financial statements will not be prevented or detected on a timely basis. In its assessment of the effectiveness of our internal control over financial reporting as of June 30, 2012, we determined that there were control deficiencies that constituted material weaknesses which are indicative of many small companies with small staff, such as:

- (1) inadequate segregation of duties and effective risk assessment; and
- (2) Insufficient written policies and procedures for accounting and financial reporting with respect to the requirements and application of both generally accepted accounting principles in the United States and guidelines of the Securities and Exchange Commission.
- (3) Inadequate closing process to ensure all material misstatements are corrected in the financial statements. This was evidenced by the fact that there were audit adjustments and restatements of the financial statements.



## Table of Contents

These control deficiencies resulted in a reasonable possibility that a material misstatement of the annual or interim financial statements could not have been prevented or detected on a timely basis. As a result of the material weaknesses described above, we concluded that we did not maintain effective internal control over financial reporting as of June 30, 2012, based on criteria established in Internal Control—Integrated Framework issued by COSO. Our management is currently evaluating remediation plans for the above deficiencies. During the period covered by this annual report on Form 10-K, we have not been able to remediate the weaknesses described above. However, we plan to take steps to enhance and improve the design of our internal control over financial reporting.

### Changes in Internal Control

There were no significant changes in the Company's internal controls over financial reporting or in other factors that could significantly affect these controls over financial reporting that occurred subsequent to the date of their evaluation and up to the filing date of this quarterly report on Form 10-Q.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

### Part II Other Information

#### Item 1. Legal Proceedings.

On June 23, 2012, the Company initiated litigation against a former client (the "Defendant") for failure to pay the Company's invoices for services rendered under its Master License and Services Agreement. The complaint was filed in Superior Court of California, San Diego County. The litigation seeks to recover \$67,795 in services and interest penalties. As of August 9, 2012, the Defendant has not responded to the complaint.

#### Item 1A. Risk Factors.

##### Risks Related to our Business

We may not have the liquidity to settle our bridge notes at maturity.

Our \$4,347,419 principal amounts currently outstanding of bridge notes (plus interest accrued at 10% annually) have a maturity date of October 15, 2012. There is no certainty that we will have the liquidity necessary to settle the bridge notes including accrued interest at the maturity date, nor is it certain that the bridge lenders will agree to an extension of the maturity date or an accommodation favorable to us. Our obligations under the bridge notes are secured by all of our assets. In the event we cannot settle the bridge notes at the maturity date or reach an accommodation with the bridge lenders, they may declare a default and foreclose on our assets. If that were to occur, our operations would be severely jeopardized if not entirely curtailed. We are currently in negotiations with these note holders to extend the maturity or convert into equity.

We will need to raise additional capital to grow our business.

We anticipate, based on currently proposed plans and assumptions relating to our ability to market and sell our products, that our cash on hand and revenues from operations will not satisfy our operational and capital requirements for the next 12 months. Further, the operation of our business and our efforts to grow our business further both through acquisitions and organically will require significant cash outlays and commitments. The timing and amount of

our cash needs may vary significantly depending on numerous factors, including but not limited to:

- market acceptance of our mobile marketing and advertising services;
- the need to adapt to changing technologies and technical requirements;
- the need to adapt to changing regulations requiring changes to our processes or platform; and
- the existence and cost of opportunities for expansion through internal growth and acquisitions.

## Table of Contents

As a result, we will need to seek additional capital, potentially through debt, or equity financings, to fund our growth. We may not be able to raise cash on terms acceptable to us or at all. Financings, if available, may be on terms that are dilutive to our shareholders, and the prices at which new investors would be willing to purchase our securities may be lower than the current price of our ordinary shares. The holders of new securities may also receive rights, preferences or privileges that are senior to those of existing holders of our ordinary shares. If new sources of financing are required but are insufficient or unavailable, we would be required to modify our growth and operating plans to the extent of available funding, which could harm our ability to grow our business.

If we do not generate significant additional revenue we will continue to receive a going concern qualification in our audit.

Our financial statements have been prepared on a going concern basis of accounting, which contemplates continuity of operations, realization of assets and liabilities and commitments in the normal course of business. The financial statements do not reflect any adjustments that might result if we are unable to continue as a going concern. We do not generate sufficient revenue and have negative cash flow from operations, which raise substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern and appropriateness of using the going concern basis is dependent upon, among other things, an additional cash infusion. We are actively seeking new investors.

We may not be successful in executing our acquisition strategy.

Our future growth will also depend on the successful continued execution of our acquisition strategy. If we are unable to acquire other companies in the mobile marketing sector, our growth, valuation and prospects will be adversely affected. It is possible that acquisition targets will not be receptive to either the valuation offered or our intention to pay for acquisitions using our common stock as the “currency”. If we are unable to grow other than organically, our growth prospects will be reduced and our ability to raise capital on acceptable terms and the value of our common stock will both be compromised.

In addition, our future acquisitions may be expensive and time-consuming and we may not realize anticipated benefits from them. The specific risks we may encounter in these types of transactions include the following:

- Potentially dilutive issuances of our securities, the incurrence of debt and contingent liabilities and amortization expenses related to intangible assets, which could adversely affect our results of operations and financial condition;
- The possibility that staff or customers of the acquired company might not accept new ownership and may transition to different technologies or attempt to renegotiate contract terms or relationships;
- The possibility that the due diligence process in any such acquisition may not completely identify material issues associated with product and service quality, intellectual property issues, key personnel issues or legal and financial contingencies; and
- Difficulty in integrating acquired operations due to technology constraints or geographical distance.

A failure to successfully integrate acquired businesses for any of these reasons could have a material adverse effect on our results of operations.

## Table of Contents

Our sales efforts to large enterprises require significant time and effort and could hinder our ability to expand our customer base and increase revenue.

Attracting new customers to our large enterprise division requires substantial time and expense, especially in an industry that is so heavily dependent on personal relationships with executives. We cannot assure that we will be successful in establishing new relationships, or maintaining or advancing our current relationships. For example, it may be difficult to identify, engage and market to customers who do not currently perform mobile marketing or advertising or are unfamiliar with our current services or platform. Further, many of our customers typically require input from one or more internal levels of approval. As a result, during our sales effort, we must identify multiple people involved in the purchasing decision and devote a sufficient amount of time to presenting our products and services to those individuals. The complexity of our services, including our software-as-a-service model, often requires us to spend substantial time and effort assisting potential customers in evaluating our products and services including providing demonstrations and benchmarking against other available technologies. We expect that our sales process will become less burdensome as our products and services become more widely known and used. However, if this change does not occur, we will not be able to expand our sales effort as quickly as anticipated and our sales will be adversely affected.

We may not be able to enhance our mobile marketing and advertising platform to keep pace with technological and market developments, or to remain competitive against potential new entrants in our markets.

The market for mobile marketing and advertising services is emerging and is characterized by rapid technological change, evolving industry standards, frequent new product introductions and short product life cycles. Our current platform or platforms we may offer in the future may not be acceptable to marketers and advertisers. To keep pace with technological developments, satisfy increasing customer requirements and achieve acceptance of our marketing and advertising campaigns, we will need to enhance our current mobile marketing solutions and continue to develop and introduce on a timely basis new, innovative mobile marketing services offering compatibility, enhanced features and functionality on a timely basis at competitive prices. Our inability, for technological or other reasons, to enhance, develop, introduce and deliver compelling mobile marketing services in a timely manner, or at all, in response to changing market conditions, technologies or customer expectations could have a material adverse effect on our operating results or could result in our mobile marketing services platform becoming obsolete. Our ability to compete successfully will depend in large measure on our ability to maintain a technically skilled development and engineering staff and to adapt to technological changes and advances in the industry, including providing for the continued compatibility of our mobile marketing services platform with evolving industry standards and protocols. In addition, as we believe the mobile marketing market is likely to grow substantially, other companies which are larger and have significantly more capital to invest than us may emerge as competitors. For example, in May 2010, Google, Inc. acquired Admob, Inc. Similarly, in January 2010, Apple, Inc. acquired Quattro Wireless, Inc. New entrants could seek to gain market share by introducing new technology or reducing pricing. This may make it more difficult for us to sell our products and services, and could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses or the loss of market share or expected market share, any of which may significantly harm our business, operating results and financial condition.

Our enterprise customer contracts lack uniformity and often are complex, which subjects us to business and other risks.

A portion of our customers include some of the largest enterprises which have substantial purchasing power and negotiating leverage. As a result, we typically negotiate contracts on a customer-by-customer basis and our contracts lack uniformity and are often complex. If we are unable to effectively negotiate, enforce and account and bill in an accurate and timely manner for contracts with our key customers, our business and operating results may be adversely affected. In addition, we could be unable to timely recognize revenue from contracts that are not managed effectively

and this would further adversely impact our financial results.

-36-

---

## Table of Contents

Our services are provided on mobile communications networks that are owned and operated by third parties who we do not control and the failure of any of these networks would adversely affect our ability to deliver our services to our customers.

Our mobile marketing and advertising platform is dependent on the reliability of mobile operators who maintain sophisticated and complex mobile networks. Such mobile networks have historically, and particularly in recent years, been subject to both rapid growth and technological change. If the network of a mobile operator with which we are integrated should fail, including because of new technology incompatibility, the degradation of network performance under the strain of too many mobile consumers using it, or a general failure from natural disaster or political or regulatory shut-down, we will not be able provide our services to our customers through such mobile network. This in turn, would impair our reputation and business, potentially resulting in a material, adverse effect on our financial results.

If our mobile marketing and advertising services platform does not scale as anticipated, our business will be harmed.

We must be able to continue to scale to support potential ongoing substantial increases in the number of users in our actual commercial environment, and maintain a stable service infrastructure and reliable service delivery for our mobile marketing and advertising campaigns. In addition, we must continue to expand our service infrastructure to handle growth in customers and usage. If our mobile marketing services platform does not efficiently and effectively scale to support and manage a substantial increase in the number of users while maintaining a high level of performance, the quality of our services could decline and our business will be seriously harmed. In addition, if we are unable to secure data center space with appropriate power, cooling and bandwidth capacity, we may not be able to efficiently and effectively scale our business to manage the addition of new customers and overall mobile marketing campaigns.

The success of our business depends, in part, on wireless carriers continuing to accept our customers' messages for delivery to their subscriber base.

We depend on wireless carriers to deliver our customers' messages to their subscriber base. Wireless carriers often impose standards of conduct or practice that significantly exceed current legal requirements and potentially classify our messages as "spam," even where we do not agree with that conclusion. In addition, the wireless carriers use technical and other measures to attempt to block non-compliant senders from transmitting messages to their customers; for example, wireless carriers block short codes or Internet Protocol addresses associated with those senders. There can be no guarantee that we, or short codes registered to us, will not be blocked or blacklisted or that we will be able to successfully remove ourselves from those lists. Although our services typically require customers to opt-in to a campaign, minimizing the risk that our customers' messages will be characterized as spam, blocking of this type could interfere with our ability to market products and services of our customers and communicate with end users and could undermine the effectiveness of our customers' marketing campaigns. To date we have not experienced any material blocking of our messages by wireless carriers, but any such blocking could have an adverse effect on our business and results of operations.

We depend on third party providers for a reliable Internet infrastructure and the failure of these third parties, or the Internet in general, for any reason would significantly impair our ability to conduct our business.

We outsource all of our data center facility management to third parties who host the actual servers and provide power and security in multiple data centers in each geographic location. These third party facilities require uninterrupted access to the Internet. If the operation of our servers is interrupted for any reason, including natural disaster, financial insolvency of a third party provider, or malicious electronic intrusion into the data center, our business would be significantly damaged. As has occurred with many Internet-based businesses, on occasion in the past, we have been

subject to "denial-of-service" attacks in which unknown individuals bombarded our computer servers with requests for data, thereby degrading the servers' performance. While we have historically been successful in relatively quickly identifying and neutralizing these attacks, we cannot be certain that we will be able to do so in the future. If either a third party facility failed, or our ability to access the Internet was interfered with because of the failure of Internet equipment in general or we become subject to malicious attacks of computer intruders, our business and operating results will be materially adversely affected.

-37-

---

Table of Contents

Failure to adequately manage our growth may seriously harm our business.

We operate in an emerging technology market and have experienced, and may continue to experience, significant growth in our business. If we do not effectively manage our growth, the quality of our products and services may suffer, which could negatively affect our brand and operating results. Our growth has placed, and is expected to continue to place, a significant strain on our managerial, administrative, operational and financial resources and our infrastructure. Our future success will depend, in part, upon the ability of our senior management to manage growth effectively. This will require us to, among other things:

- implement additional management information systems;
- further develop our operating, administrative, legal, financial and accounting systems and controls;
- hire additional personnel;
- develop additional levels of management within our company;
- locate additional office space in various countries; and
- maintain close coordination among our engineering, operations, legal, finance, sales and marketing and customer service and support organizations.

Moreover, as our sales increase, we may be required to concurrently deploy our services infrastructure at multiple additional locations or provide increased levels of customization. As a result, we may lack the resources to deploy our mobile marketing services on a timely and cost-effective basis. Failure to accomplish any of these requirements would seriously harm our ability to deliver our mobile marketing services platform in a timely fashion, fulfill existing customer commitments or attract and retain new customers.

We depend on the services of key personnel to implement our strategy. If we lose the services of our key personnel or are unable to attract and retain other qualified personnel, we may be unable to implement our strategy.

We believe that the future success of our business depends on the services of a number of key management and operating personnel, including Dennis Becker, our Chief Executive Officer, Timothy Schatz, our Chief Financial Officer, Jonathan Twomley Director of Software Engineering, and Michael Falato, Senior Vice President of Business Development. We currently have an employment agreement in place with Mr. Becker and Mr. Schatz. We do not maintain any key-person life insurance policies. Some of these key employees have strong relationships with our customers and our business may be harmed if these employees leave us. The loss of members of our key management and certain other members of our operating personnel could materially adversely affect our business, operating results and financial condition.

In addition, our ability to manage our growth depends, in part, on our ability to identify, hire and retain additional qualified employees, including a technically skilled development and engineering staff. We face intense competition for qualified individuals from numerous technology, marketing and mobile software and service companies. We require a mix of highly talented engineers as well as individuals in sales and support who are familiar with the marketing and advertising industry. In addition, new hires in sales positions require significant training and may, in some cases, take more than a year before they achieve full productivity. Our recent sales force hires and planned hires may not become as productive as we would like, and we may be unable to hire sufficient numbers of qualified individuals in the future in the markets where we do business. Further, given the rapid pace of our expansion to date, we may be unable to attract and retain suitably qualified individuals who are capable of meeting our growing, creative, operational and managerial requirements, or may be required to pay increased compensation in order to do so. If we are unsuccessful in attracting and retaining these key personnel, our ability to operate our business effectively would be negatively impacted and our business, operating results and financial condition would be adversely affected.





## Table of Contents

The gathering, transmission, storage and sharing or use of personal information could give rise to liabilities or additional costs of operation as a result of governmental regulation, legal requirements, civil actions or differing views of personal privacy rights.

We transmit and store a large volume of personal information in the course of providing our services. Federal, state and international laws and regulations govern the collection, use, retention, sharing and security of data that we receive from our customers and their users. Any failure, or perceived failure, by us to comply with U.S. federal, state, or international privacy or consumer protection-related laws, regulations or industry self-regulatory principles could result in proceedings or actions against us by governmental entities or others, which could potentially have an adverse effect on our business, operating results and financial condition. Additionally, we may also be contractually liable to indemnify and hold harmless our customers from the costs or consequences of inadvertent or unauthorized disclosure of their customers' personal data which we store or handle as part of providing our services.

The interpretation and application of privacy, data protection and data retention laws and regulations are currently unsettled in the U.S. and internationally, particularly with regard to location-based services, use of customer data to target advertisements and communication with consumers via mobile devices. Such laws may be interpreted and applied inconsistently from country to country and inconsistently with our current data protection policies and practices. Complying with these varying international requirements could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business, operating results or financial condition. As privacy and data protection have become more sensitive issues, we may also become exposed to potential liabilities as a result of differing views on the privacy of personal information. These and other privacy concerns, including security breaches, could adversely impact our business, operating results and financial condition.

In the U.S., we have voluntarily agreed to comply with wireless carrier technological and other requirements for access to their customers' mobile devices, and also trade association guidelines and codes of conduct addressing the provision of location-based services, delivery of promotional content to mobile devices and tracking of users or devices for the purpose of delivering targeted advertising. We could be adversely affected by changes to these requirements, guidelines and codes, including in ways that are inconsistent with our practices or in conflict with the rules or guidelines in other jurisdictions.

Our management team has limited experience in public company matters, which could impair our ability to comply with legal and regulatory requirements.

Our management team has only limited public company management experience or responsibilities, which could impair our ability to comply with legal and regulatory requirements such as the Sarbanes-Oxley Act of 2002 and applicable federal securities laws including filing required reports and other information required on a timely basis. There can be no assurance that our management will be able to implement and affect programs and policies in an effective and timely manner that adequately respond to increased legal, regulatory compliance and reporting requirements imposed by such laws and regulations. Our failure to comply with such laws and regulations could lead to the imposition of fines and penalties and further result in the deterioration of our business.

### Risks Related to our Common Stock

There has been a limited trading market for our common stock.

There has been a limited trading market for our common stock on the Over-the-Counter Bulletin Board. The lack of an active market may impair the ability to sell your shares at the time you wish to sell them or at a price that you consider reasonable. The lack of an active market may also reduce the fair market value of your shares. An inactive market may also impair our ability to raise capital by selling shares of capital stock and may impair our ability to

acquire other companies or technologies by using common stock as consideration.

-39-

---

## Table of Contents

Our freely trading share volume will increase significantly.

We have issued and intend to continue to issue additional common shares in the execution of our acquisition strategy, both increasing the number of free trading shares and dilution. This increase in both free trading shares and total shares outstanding may have a depressive effect on our stock price and a deleterious effect on our ability to both raise additional equity capital and complete acquisitions using our common stock as the principal currency.

You may have difficulty trading and obtaining quotations for our common stock.

Our common stock may not be actively traded, and the bid and asked prices for our common stock on the Over-the-Counter Bulletin Board may fluctuate widely. As a result, investors may find it difficult to dispose of, or to obtain accurate quotations of the price of, our securities. This severely limits the liquidity of the common stock, and would likely reduce the market price of our common stock and hamper our ability to raise additional capital.

The market price of our common stock may be, and is likely to continue to be, highly volatile and subject to wide fluctuations.

The market price of our common stock is likely to be highly volatile and could be subject to wide fluctuations in response to a number of factors that are beyond our control, including:

- dilution caused by our issuance of additional shares of common stock and other forms of equity securities, which we expect to make in connection with future acquisitions or capital financings to fund our operations and growth, to attract and retain valuable personnel and in connection with future strategic partnerships with other companies;
- announcements of new acquisitions or other business initiatives by our competitors;
- our ability to take advantage of new acquisitions or other business initiatives;
- quarterly variations in our revenues and operating expenses;
- changes in the valuation of similarly situated companies, both in our industry and in other industries;
- changes in analysts' estimates affecting us, our competitors and/or our industry;
- changes in the accounting methods used in or otherwise affecting our industry;
- additions and departures of key personnel;
- announcements by relevant governments pertaining to additional quota restrictions; and
- fluctuations in interest rates and the availability of capital in the capital markets.

These and other factors are largely beyond our control, and the impact of these risks, singly or in the aggregate, may result in material adverse changes to the market price of our common stock and/or our results of operations and financial condition.

Our operating results may fluctuate significantly, and these fluctuations may cause our stock price to decline.

Our operating results will likely vary in the future primarily as the result of fluctuations in our revenues and operating expenses, expenses that we incur, prices of feed used in our business, the price that customer are willing and able to pay for our products and other factors. If our results of operations do not meet the expectations of current or potential investors, the price of our common stock may decline.

We do not expect to pay dividends in the foreseeable future.

We do not intend to declare dividends for the foreseeable future, as we anticipate that we will reinvest any future earnings in the development and growth of our business. Therefore, investors will not receive any funds unless they sell their common stock, and stockholders may be unable to sell their shares on favorable terms or at all. Investors

cannot be assured of a positive return on investment or that they will not lose the entire amount of their investment in the common stock.

-40-

---

Table of Contents

Our directors and officers will have a high concentration of common stock ownership.

Based on the 23,214,749 shares of common stock that are outstanding as of June 30, 2012, our officers and directors will beneficially own approximately 36.9% of our outstanding common stock. Such a high level of ownership by such persons may have a significant effect in delaying, deferring or preventing any potential change in control of our company. Additionally, as a result of their high level of ownership, our officers and directors might be able to strongly influence the actions of our board of directors and the outcome of actions brought to our shareholders for approval. Such a high level of ownership may adversely affect the voting and other rights of our shareholders.

Applicable SEC rules governing the trading of “penny stocks” limit the trading and liquidity of our common stock, which may affect the trading price of our common stock.

Shares of common stock may be considered a “penny stock” and be subject to SEC rules and regulations which impose limitations upon the manner in which such shares may be publicly traded and regulate broker-dealer practices in connection with transactions in “penny stocks.” Penny stocks generally are equity securities with a price of less than \$5.00 (other than securities registered on certain national securities exchanges or quoted on the NASDAQ system, provided that current price and volume information with respect to transactions in such securities is provided by the exchange or system). The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document that provides information about penny stocks and the risks in the penny stock market. The broker-dealer must also provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction, and monthly account statements showing the market value of each penny stock held in the customer’s account. In addition, the penny stock rules generally require that prior to a transaction in a penny stock, the broker-dealer make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser’s written agreement to the transaction. These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for a stock that becomes subject to the penny stock rules which may increase the difficulty investors may experience in attempting to liquidate such securities.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the three months ended June 30, 2012, the Company sold no shares of common stock.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Removed and Reserved.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.



Table of Contents

SIGNATURES

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

CommerceTel Corporation

Date: August 14, 2012

By:

/s/ Dennis Becker  
Dennis Becker  
Chief Executive Officer  
(Principal Executive Officer)

Date: August 14, 2012

By:

/s/ Timothy Schatz  
Timothy Schatz  
Chief Financial Officer



Table of Contents

## Exhibit Index

Exhibit Number	Description
31.1	Certification of Dennis Becker, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Tim Schatz, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Dennis Becker, Chief Executive Officer, and Tim Schatz, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase*
101.DEF	XBRL Taxonomy Extension Definition Linkbase*
101.LAB	XBRL Taxonomy Extension Label Linkbase*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase*

\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.