MobileSmith, Inc.
Form 10-Q
May 15, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

Commission File Number: 001-32634

MOBILESMITH, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-4439334 (I.R.S. Employer Identification No.)
5400 Trinity Road, Suite 208 Raleigh, North Carolina (Address of principal executive offices)	27607 (Zip Code)

(855) 516-2413
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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¨ (Do not check if a smaller reporting company)	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 o No x

As of May 13, 2014, there were 19,827,542 shares of the registrant's common stock, par value $0.001 per share, outstanding.

MOBILESMITH, INC.

FORM 10-Q
For the Quarterly Period Ended March 31, 2014

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

MOBILESMITH, INC.
CONDENSED BALANCE SHEETS

ASSETS

	March, 31 2014 (unaudited)	December, 31 2013
Current Assets		
Cash and Cash Equivalents	$284,132	$223,514
Restricted Cash	81,201	131,757
Trade Accounts Receivable, Net	181,065	48,885
Prepaid Expenses and Other Current Assets	63,551	97,957
Total Current Assets	609,949	502,113
Property & Equipment, Net	136,736	140,383
Capitalized Software, Net	607,736	636,061
Intangible Assets, Net	134,622	138,992
Other Assets	38,493	15,370
Total Non-Current Assets	917,587	930,806
Total Assets	$1,527,536	$1,432,919

LIABILITIES AND STOCKHOLDERS DEFICIT

	March, 31 2014 (unaudited)	December, 31 2013
Current Liabilities		
Trade Accounts Payable	$76,105	$58,901
Accrued Expenses	276,345	267,425
Accrued Interest	294,629	290,560
Notes Payable, Current	5,026,639	5,026,113
Deferred Revenue	289,098	163,868
Total Current Liabilities	5,962,816	5,806,867
Long-Term Liabilities		
Notes Payable, Related Parties, Net of Discount	23,363,692	23,512,836
Notes Payable, Non-current	730,770	730,770
Capital Lease Obligations	136,495	142,986
Deferred Rent	63,285	25,314
Total Long-Term Liabilities	24,294,242	24,411,906
Total Liabilities	30,257,058	30,218,773
Commitments and Contingencies (Note 3)		
Stockholders' Deficit		
Preferred Stock, $0.001 par value, 5,000,000 shares authorized, no shares issued and outstanding at March 31, 2014 and December 31, 2013	-	-
Common Stock, $0.001 par value, 45,000,000 shares authorized, 19,827,542 shares issued and outstanding at March 31, 2014 and December 31, 2013	19,828	19,828
Additional Paid-in Capital	94,713,344	93,059,983
Accumulated Deficit	(123,462,694)	(121,865,665)

Total Stockholders' Deficit	(28,729,522)	(28,785,854)
Total Liabilities and Stockholders' Deficit	$1,527,536	$1,432,919

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

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MOBILESMITH, INC.
CONDENSED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended	
	March 31, 2014	March 31, 2013
REVENUES:		
Total Revenues	$187,945	$64,456
COST OF REVENUES	135,587	143,300
GROSS PROFIT (LOSS)	52,358	(78,844)
OPERATING EXPENSES:		
Sales and Marketing	220,157	287,312
Research and Development	268,877	167,830
General and Administrative	335,167	407,895
Total Operating Expenses	824,201	863,037
LOSS FROM OPERATIONS	(771,843)	(941,881)
OTHER INCOME (EXPENSE):		
Other Income	1,256	-
Interest expense, net	(826,442)	(472,338)
Total other expense	(825,186)	(472,338)
LOSS FROM CONTINUING OPERATIONS	$(1,597,029)	$(1,414,219)
Income (loss) from discontinued operations	-	(13,585)
NET LOSS	$(1,597,029)	$(1,427,804)
NET LOSS PER COMMON SHARE:		
Basic and fully diluted from continuing operations	$(0.08)	$(0.08)
Basic and fully diluted from discontinued operations	$0.00	$0.00
WEIGHTED-AVERAGE NUMBER OF SHARES USED IN COMPUTING NET LOSS PER COMMON SHARE:		
Basic And Fully Diluted	19,827,542	18,352,542

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

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MOBILESMITH, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(unaudited)

	Three Months Ended	
	March 31, 2014	March 31, 2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Loss	$(1,597,029)	$(1,427,804)
Adjustments to Reconcile Net Loss to Net Cash Used in Operating Activities:		
Depreciation and Amortization	41,507	35,091
Amortization of Debt Discount	246,213	-
Share Based Compensation	28,004	12,181
Changes in Assets and Liabilities:		
Accounts Receivable	(132,180)	(7,694)
Prepaid Expenses and Other Current Assets	11,283	29,097
Accounts Payable	17,204	56,888
Deferred Revenue	125,230	22,137
Accrued and Other Expenses	50,960	86,456
Net Cash Used in Operating Activities	(1,208,808)	(1,193,648)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments to Acquire Property, Plant and Equipment	(5,165)	(16,588)
Payments to Acquire Intangible Assets	-	(12,695)
Investment in Internally Developed Software	-	(48,961)
Net Cash Used in Investing Activities	(5,165)	(78,244)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Restricted Cash Used to Pay IDB Interest Expense	50,556	32,778
Proceeds from Issuance of Long Term Debt	1,230,000	1,260,000
Repayments of Debt Borrowings	(5,965)	(16,197)
Net Cash Provided by Financing Activities	1,274,591	1,276,581
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	60,618	4,689
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	223,514	58,458
CASH AND CASH EQUIVALENTS, END OF PERIOD	$284,132	$63,147
Supplemental Disclosures of Cash Flow Information:		
Cash Paid During the Period for Interest	$577,271	$445,211
Non-Cash Investing and Financing Activities		
The Company Recorded Debt Discount Associated with Beneficial Conversion Feature	$1,625,357	$-

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

MOBILESMITH, INC.
CONDENSED STATEMENT OF STOCKHOLDERS' DEFICIT
FOR THE PERIOD ENDED MARCH 31, 2014

	Common Stock		Additional		
		$0.001	Paid-In	Accumulated	
	Shares	Par Value	Capital	Deficit	Totals
BALANCES, DECEMBER 31, 2013	19,827,542	$19,828	$93,059,983	$(121,865,665)	$(28,785,854)
Equity-Based Compensation			28,004		28,004
Beneficial Conversion Feature Recorded as a Result of Issuance of June 27, 2013 Debt Modification and Subsequent Issuance of Convertible Debt			1,625,357		1,625,357
Net Loss				(1,597,029)	(1,597,029)
BALANCES, MARCH 31, 2014	19,827,542	$19,828	$94,713,344	$(123,462,694)	$(28,729,522)

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

MOBILESMITH, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
For the Quarterly Period Ended March 31, 2014
(unaudited)

1. DESCRIPTION OF BUSINESS AND BASIS OF PRESENTATION

MobileSmith, Inc. (referred to herein as the “Company,” “us,” “we,” or “our”) was incorporated as Smart Online, Inc. in the State of Delaware in 1993. The Company changed its name to MobileSmith, Inc. effective July 1, 2013. The Company develops and markets software products and services tailored to users of mobile devices. The Company’s flagship product is the MobileSmith™ Platform (the “Platform”). The Platform is an innovative, patents pending mobile app development platform that enables organizations to rapidly create, deploy, and manage custom, native smartphone and tablet apps deliverable across iOS and Android mobile platforms.

The Company’s principal products and services include:

- Subscription to its Software as a Service (“SaaS”) cloud based mobile app development platform to customers who design and build their own apps;
- Custom mobile application design and development services provided by the Company;
- Mobile application marketing services; and
- Mobile strategy implementation consulting.

The Company prepared the accompanying unaudited condensed financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its audited annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In management’s opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its financial position, results of operations, cash flows and stockholder deficit as of March 31, 2014. The Company’s interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the audited financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013, as amended, on file with the SEC (the “Annual Report”).

There have been no material changes to the Company’s significant accounting policies as compared to the significant accounting policies described in the Annual Report.

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. During the three months ended March 31, 2014 and 2013, the Company incurred net losses as well as negative cash flows and, at March 31, 2014 and 2013, had deficiencies in working capital. These factors indicate that the Company may be unable to continue as a going concern. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts or classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

Certain prior year balances were reclassified in connection with the presentation of discontinued operations of legacy domain hosting operations and the presentation of debt balances as of March 31, 2014.

2. DEBT

The table below summarizes the Company's debt at March 31, 2014 and December 31, 2013:

Debt Description		March 31, 2014		December 31, 2013	Maturity	Rate	
IDB Credit Facility	$	5,000,000	$	5,000,000	14-May	4	%
Capital lease obligations - Noteholder lease		128,008		132,321	19-Aug	8	%
Capital lease obligations - Office furniture		35,126		36,778	18-Sep	9.8	%
Convertible notes - related parties, net of discount of $3,300,538 and $1,921,394, respectively		23,363,692		23,512,836	16-Nov	8	%
Convertible notes		730,770		730,770	16-Nov	8	%
Total debt		29,257,596		29,412,705			
Less: current portion of long term debt							
Capital lease obligations		26,639		26,113			
IDB Credit Facility		5,000,000		5,000,000			
Total current portion of long term debt		5,026,639		5,026,113			
Debt - long term	$	24,230,957	$	24,386,592			

Convertible Notes

During the three months ended March 31, 2014, the Company sold $1,230,000 of additional Convertible Secured Subordinated Promissory Notes (the "Notes") to Union Bancaire Privée ("UBP") under its existing Convertible Secured Subordinated Note Purchase Agreement, dated November 14, 2007, as amended (as so amended, the "Note Purchase Agreement") at conversion prices equal to $.56 on the date of sale. The Company recorded a beneficial conversion feature of $1,625,357 and corresponding debt discount, which is being amortized into interest expense through the maturity of the Notes.

IDB Credit Facility and New Facility Commitment

The Company has an outstanding promissory note with Israel Discount Bank ("IDB") that has a maturity date of May 31, 2014 (the "IDB Credit Facility"). Borrowings under the IDB Credit Facility were guaranteed by Atlas Capital SA ("Atlas") and subsequent to the merger between Atlas and Mirelis InvesTrust SA ("Mirelis"), by Mirelis. The IDB Credit Facility is further secured by an extended irrevocable standby letter of credit issued by UBS Private Bank with an expiration date of November 30, 2015.

The Company has obtained a bank commitment letter to borrow up to $5,000,000 under a facility with substantially the same terms as the IDB Credit Facility (the "New Facility"). If finalized, the proceeds of the New Facility would be used to repay the IDB Credit Facility on or before its maturity date.

3. COMMITMENTS AND CONTINGENCIES

Aggregate future lease commitments

The Company leases computers, office equipment and office furniture under capital lease agreements that expire through August 2019. Total amounts financed under these capital leases were $163,134 and $169,099 at March 31, 2014 and December 31, 2013, respectively. These obligations are included within the Company's total debt.

The table below summarizes Company's future obligations under its capital leases:

Year:	
2014	$29,444
2015	39,259
2016	39,259
2017	39,259
2018	34,189
Thereafter	19,412
	200,822
Less amount representing interest	(37,688)
Capital lease obligations	$163,134

The Company leases its office space in Raleigh, North Carolina pursuant to a lease with an initial term that expires in March 2019. The lease contains an option to renew for two, three-year terms. In addition, the Company leases a vehicle pursuant to a lease that expires in July 2016.

The table below summarizes the Company's future obligations under its office and vehicle leases:

Year:	
2014	$ 118,878
2015	162,528
2016	165,678
2017	167,786
2018	172,418
Thereafter	44,082
Total	$ 831,370

Legal Proceedings

The Company may be subject to legal proceedings and litigation arising in the ordinary course of business, including, but not limited to, certain pending patent and privacy matters, including class action lawsuits, as well as inquiries, investigations, audits and other regulatory proceedings.

The Company will record a liability when it believes that it is both probable that a loss has been incurred and the amount can be reasonably estimated. The Company periodically evaluates developments in its legal matters that could affect the amount of liability that it has previously accrued, if any, and makes adjustments as appropriate. Significant judgment is required to determine both the likelihood of there being, and the estimated amount of, a loss related to such matters, and the Company's judgment may be incorrect. The outcome of any proceeding is not determinable in

advance. Until the final resolution of any such matters that the Company may be required to accrue for, there may be an exposure to loss in excess of the amount accrued, and such amounts could be material.

4. EQUITY COMPENSATION

The following is a summary of the stock option activity for the three months ended March 31, 2014:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding, December 31, 2013	530,378	$ 1.99		
Cancelled	(78,750)	5.00		
Issued	-	-		
Outstanding, March 31, 2014	451,628	1.46	5.07	$ 20,800
Vested and exercisable, March 31, 2014	159,921	$ 1.29	6.00	$ 17,025

Aggregate intrinsic value represents the difference between the closing price of the Company's common stock, par value $0.001 per share (the "Common Stock") at March 31, 2014 and the exercise price of outstanding, in-the-money stock options. The closing price of the Common Stock at March 31, 2014, as reported on the Over-the-Counter Bulletin Board, was $1.30 per share.

At March 31, 2014, $242,000 of unvested expense has yet to be recorded related to outstanding stock options.

5. MAJOR CUSTOMERS AND CONCENTRATION

For the three months ended March 31, 2014, three major customers accounted for 34% of total revenues and two customers accounted for 73% of the accounts receivable balance. For the three months ended March 31, 2013, two major customers accounted for 27% of total revenues and two customers accounted for 75% of the accounts receivable balance.

6. SUBSEQUENT EVENTS

Subsequent to March 31, 2014, the Company sold two Notes totaling $810,000 to UBP on the same terms as previously sold Notes. The Notes will mature on November 14, 2016.

On May 12, 2014, the Company entered into the Seventh Amendment to Convertible Secured Subordinated Note Purchase Agreement (the "Seventh Amendment") and the Fifth Amendment to Convertible Secured Subordinated Promissory Notes (the "Fifth Amendment"), with the holders of a majority of the aggregate outstanding principal amount of the Notes issued by the Company under the Note Purchase Agreement (collectively, the "Noteholders"). The Seventh Amendment and the Fifth Amendment apply to all $28,205,000 in principal amount of Notes outstanding as of May 12, 2014 and all future Notes. As amended, the Notes have the following terms:

a maturity date of the earlier of (i) November 14, 2016, (ii) a Change of Control (as defined in the Note Purchase Agreement), or (iii) when, upon or after the occurrence of an Event of Default (as defined in the Note Purchase Agreement) such amounts are declared due and payable by a Noteholder or made automatically due and payable in accordance with the terms of the Note Purchase Agreement;

an interest rate of 8% per year;

a total borrowing commitment of $33.3 million;

a conversion price that is fixed at $1.43; and

optional conversion upon Noteholder request, provided that if at the time of any particular requested conversion the Company does not have a sufficient number of shares of its common stock authorized to allow for such conversion as well as the issuance of the maximum amount of common stock permitted under the Company’s 2004 Equity Compensation Plan, the Noteholder may request that the Company call a special meeting of the stockholders specifically for the purpose of increasing the number of shares of common stock authorized to cover the remaining portion of the Notes outstanding as well as the maximum issuances contemplated pursuant to the Company’s 2004 Equity Compensation Plan.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Information set forth in this Quarterly Report on Form 10-Q contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act") and other laws. Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our plan to build our business and the related expenses, our anticipated growth, trends in our business, the potential impact of current or future litigation and government investigations, our ability to continue as a going concern, and the sufficiency of our capital resources including funds available under our existing credit facility or any replacement facility, the funds available under our Note facility and the future sales of Notes, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as "expect," "anticipate," "project," "intend," "plan," "estimate," variations of su words, and similar expressions also are intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are directed to risks and uncertainties identified under Part I, Item 1A, "Risk Factors," in the Annual Report and our subsequent periodic reports filed with the SEC for factors that may cause actual results to be different than those expressed in these forward-looking statements. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

The following discussion is designed to provide a better understanding of our unaudited financial statements, including a brief discussion of our business and products, key factors that impacted our performance, and a summary of our operating results. The following discussion should be read in conjunction with the unaudited condensed financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Annual Report. Historical results and percentage relationships among any amounts in the financial statements are not necessarily indicative of trends in operating results for any future periods.

Overview

We develop and market a software-as-a-service ("SaaS") platform that allows non-programmers to design and build native mobile applications for smartphones and tablets. Our flagship product is the Platform. Platform related services often include data integration and training. We also provide consulting services, which include assistance with design and implementation of mobile strategy, implementation of mobile marketing strategy and the development of mobile apps.

We use a SaaS business model – the customers acquire access to the Platform through user subscription agreements and are able to obtain total control of mobile app production. Our business model allows for creation and management of any desired number of apps by our customers for a monthly license fee. The on-demand SaaS model developed using multi-tenant architecture enables end users to visit a website and use the SaaS applications, all via a web browser, with no installation, no special information technology knowledge, and no maintenance. The SaaS application is transformed into a service that can be used anytime and anywhere by the end user. Multi-tenant SaaS applications also permit us to add needed functionality to our applications in one location for the benefit of all end users. This capability allows us to provide upgrades universally.

Target Market and Sales Channels

We believe that the do-it-yourself model for creation and management of apps will become a cost effective solution for enterprise clients who have an ever increasing need to interact with their customers and employees through mobile

devices. Single apps may reach their limits of usability very quickly, if made complex. The Platform offers an ability to create multiple, customized non-template apps with designated functionalities and specific designs without incurring additional costs.

Our market penetration strategy focuses on three distinct sectors:

Government:

We believe that the Platform has a unique capability to service various structures within federal, state and local governments, as government structure is highly segmented by function and territory. In addition, the Platform can be safely placed behind the firewalls of individual departments, where data security is a primary concern. Replicating the Platform and placing it behind a secure firewall would allow an organization to create and manage multiple mobile apps with targeted functionality for targeted audiences without going outside of the secure firewall.

Healthcare clients:

Healthcare organizations, such as hospitals and healthcare networks, are akin to government in their departmental segmentation and territorial reach. Additionally, healthcare companies are subject to increased regulation as a result of the Affordable Care Act and may be subject to penalties for delivering inefficient care under new Medicare regulations. Hospitals increasingly turn to portfolios of apps to increase efficiency and remain competitive: outpatient care apps, wellness apps, physician referral apps, appointment apps, discharge apps and others. We believe that the Platform has a significant competitive advantage in the healthcare space due to the ability to deliver a variety of targeted mobile solutions cost effectively.

Enterprise clients:

The third sector combines all other large and multi-national enterprise clients, where large-scale customization based on functionality or territory is of the highest value, and other contributors such as time to market, technology reach, and ease of use play important roles. These target clients may include large food chains, media and PR companies, software solutions providers, hardware manufacturers, mortgage brokers and real estate franchises.

Results of Operations for the Three Months Ended March 31, 2014 and March 31, 2013

Revenue

We generated revenues of $187,945 in the three months ended March 31, 2014, which is a 192% increase from $64,456 in the three months ended March 31, 2013. We continue to expand our mobile presence in the market. Our number of customers increased by 41% in the three months ended March 31, 2014, as compared to three months ended March 31, 2013.

Cost of Revenue and Gross Profit

Cost of revenue decreased by $7,713 to $135,587 in the three months ended March 31, 2014, or a decrease of 5% from $143,300 in the three months ended March 31, 2013. Gross profit increased by $131,202, for a profit of $52,358, in the three months ended March 31, 2014, compared to a loss of $78,844 in the three months ended March 31, 2013. The increase in gross profit is attributable to an increase in revenue due to the addition of new customers, with the costs of realizing that revenue remaining relatively unchanged.

Sales and Marketing

Sales and marketing expenses were $220,157 in the three months ended March 31, 2014, a decrease of $67,155, or 23%, from $287,312 in the three months ended March 31, 2013. The decrease is due to a decrease in tradeshow and marketing campaign related expenses of approximately $10,000 and a decrease due to internal re-allocation of

Company employee wages among the Company departments by function of approximately $57,000.

Research and Development

Research and development expenses were $268,877 in the three months ended March 31, 2014, an increase of $101,047, or 60%, from $167,830 in the three months ended March 31, 2013. Payroll and related expenses of our development team increased by $30,147 in the three months ended March 31, 2014, compared to the three months ended March 31, 2013, due to the continued expansion of our development team to support new features of the Platform. In addition, stock based compensation increased by $12,545 in the three months ended March 31, 2014, compared to the three months ended March 31, 2013, resulting from the recognition of expenses related to stock options granted in September 2013. An additional increase of approximately $50,000 is attributable to development expenses that were capitalized as software development costs during the three months ended March 31, 2013, compared to $0 in the three months ended March 31, 2014. We believe that the current composition of our development team is sufficient for implementation of our research and development strategy and to support our growth.

General and Administrative

General and administrative expenses were $335,167 in the three months ended March 31, 2014, compared to $407,895 in the three months ended March 31, 2013, a decrease of $72,728, or 18%. The decrease is due to a reduction in the legal and professional fees associated with a network breach incident that occurred in June 2012.

Interest expense

Net interest expense was $826,442 in the three months ended March 31, 2014, compared to $472,338 in the three months ended March 31, 2013, an increase of $354,104, or 75%. Approximately $100,000 is related to a general increase in debt and approximately $250,000 is related to the amortization of debt discount, which is included in interest expense.

Liquidity and Capital Resources

We have not yet achieved positive cash flows from operations, and our main source of funds for our operations is the sale of additional Notes. We must continue to rely on this source until we are able to generate sufficient cash from revenues to fund our operations. We believe that anticipated cash flows from operations, and additional issuances of Notes, together with cash on hand, will provide sufficient funds to finance our operations at least for the next 12 to 18 months, depending on our ability to achieve strategic goals outlined in our annual operating budget approved by the Board of Directors. Changes in our operating plans, lower than anticipated sales, increased expenses, or other events may cause us to seek additional equity or debt financing in future periods. There can be no guarantee that financing will be available on acceptable terms or at all. Additional equity and convertible debt financing could be dilutive to the holders of shares of our common stock, and additional debt financing, if available, could impose greater cash payment obligations and more covenants and operating restrictions.

Uses of Cash

During the three months ended March 31, 2014, we used in operating activities approximately $1.38 million, which was offset by approximately $170,000 in cash collected from our customers; approximately $577,000 was used to pay interest payments on the Notes; approximately $545,000 was used for payroll, benefits and related costs; approximately $60,000 was used on non-payroll related sales and marketing efforts; and approximately $200,000 was used for general and administrative expenses.

Capital Expenditures and Investing Activities

Our capital expenditures are limited to the purchase of new office equipment and new mobile devices that are used for testing. Cash used for investing activities in the three months ended March 31, 2014 was insignificant. We are not planning any significant capital expenditures in the near future.

Financing Activities and Sources of Cash

Since November 14, 2007, we have financed our working capital deficiency primarily with the issuance of Notes under the Note Purchase Agreement. During the three months ended March 31, 2014, we borrowed an additional $1,230,000 under the Note Purchase Agreement. The aggregate outstanding amount of the Notes, as of March 31, 2014, was $24,094,462, net of a discount of $3,300,538.

On May 12, 2014, we entered into the Seventh Amendment to the Note Purchase Agreement and the Fifth Amendment to the Notes with a majority of the Noteholders. The Seventh Amendment and the Fifth Amendment apply to all $28,205,000 in principal amount of Notes outstanding as of May 12, 2014 and all future Notes. As amended, the Notes have the following terms:

a maturity date of the earlier of (i) November 14, 2016, (ii) a Change of Control (as defined in the Note Purchase Agreement), or (iii) when, upon or after the occurrence of an Event of Default (as defined in the Note Purchase Agreement) such amounts

are declared due and payable by a Noteholder or made automatically due and payable in accordance with the terms of the Note Purchase Agreement;
an interest rate of 8% per year;
a total borrowing commitment of $33.3 million;
a conversion price that is fixed at $1.43; and
optional conversion upon Noteholder request, provided that if at the time of any particular requested conversion we do not have a sufficient number of shares of our common stock authorized to allow for such conversion as well as the issuance of the maximum amount of common stock permitted under our 2004 Equity Compensation Plan, the Noteholder may request that we call a special meeting of the stockholders specifically for the purpose of increasing the number of shares of common stock authorized to cover the remaining portion of the Notes outstanding as well as the maximum issuances contemplated pursuant to our 2004 Equity Compensation Plan.

The Company has an outstanding promissory note with IDB that has a maturity date of May 31, 2014. Borrowings under the IDB Credit Facility were guaranteed by Atlas and subsequent to the merger between Atlas and Mirelis, by Mirelis. The IDB Credit Facility is further secured by an extended irrevocable standby letter of credit issued by UBS Private Bank with an expiration date of November 30, 2015.

The Company has obtained a bank commitment letter to borrow up to $5,000,000 under a facility with substantially the same terms as the IDB Credit Facility. The Company expects to close on the New Facility on or before before the maturity date of the IDB Credit Facility on May 31, 2014. The proceeds of the New Facility will be used to repay the IDB Credit Facility on or before its maturity date.

If the Company does not close on the New Facility on or before May 31, 2014, or replace IDB with another lender, IDB will likely execute on the letter of credit issued by UBS and the proceeds of the New Facility or alternate financing will be used to repay UBS.

Off Balance Sheet Arrangements

As of March 31, 2014, we had no off balance sheet arrangements that have had or that we expect would be reasonably likely to have a future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Going Concern

We have not yet achieved positive cash flows from operations, and our main source of funds for our operations is the sale of additional Notes. We must continue to rely on this source until we are able to generate sufficient cash from revenues to fund our operations. Changes in our operating plans, lower than anticipated sales, increased expenses, or other events may cause us to seek additional equity or debt financing in future periods. There can be no guarantee that financing will be available on acceptable terms or at all. Additional equity financing could be dilutive to the holders of shares of our common stock, and additional debt financing, if available, could impose greater cash payment obligations and more covenants and operating restrictions on us.

Our independent registered public accounting firm has issued an emphasis of matter paragraph in their report included in the Annual Report in which they express substantial doubt as to our ability to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts or classification of liabilities that might be necessary should we be unable to continue as a going concern. Our continuation as a going concern depends on our ability to generate sufficient cash flows to meet our obligations on a timely basis, to obtain additional financing that is currently required, and ultimately to attain profitable operations and positive cash flows. There can be no assurance that our efforts to raise capital or increase revenue will be successful. If our efforts are unsuccessful, we may have to cease operations and liquidate our business.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures for the three months ended March 31, 2014. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow for timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2014, our disclosure controls and procedures were effective at a reasonable assurance level.

There has been no change to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the three months ended March 31, 2014 that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 5. OTHER INFORMATION

On May 8, 2014, the Company entered into the Seventh Amendment to the Note Purchase Agreement and the Fifth Amendment to the Notes with a majority of the Noteholders. The Seventh Amendment and the Fifth Amendment apply to all $28,205,000 in principal amount of Notes outstanding as of May 8, 2014 and all future Notes. As amended, the Notes have the following terms:

- a maturity date of the earlier of (i) November 14, 2016, (ii) a Change of Control (as defined in the Note Purchase Agreement), or (iii) when, upon or after the occurrence of an Event of Default (as defined in the Note Purchase Agreement) such amounts are declared due and payable by a Noteholder or made automatically due and payable in accordance with the terms of the Note Purchase Agreement;
- an interest rate of 8% per year;
- a total borrowing commitment of $33.3 million;
- a conversion price that is fixed at $1.43; and
- optional conversion upon Noteholder request, provided that if at the time of any particular requested conversion the Company does not have a sufficient number of shares of its common stock authorized to allow for such conversion as well as the issuance of the maximum amount of common stock permitted under the Company’s 2004 Equity Compensation Plan, the Noteholder may request that the Company call a special meeting of the stockholders specifically for the purpose of increasing the number of shares of common stock authorized to cover the remaining portion of the Notes outstanding as well as the maximum issuances contemplated pursuant to the Company’s 2004 Equity Compensation Plan.

ITEM 6. EXHIBITS

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation, dated January 4, 2005, as amended to date (incorporated herein by reference to Exhibit 3.1 to our Quarterly Report on Form 10-Q, as filed with the SEC on August 14, 2013)
3.2	Seventh Amended and Restated Bylaws, effective July 1, 2013 (incorporated herein by reference to Exhibit 3.3 to our Quarterly Report on Form 10-Q, as filed with the SEC on August 14, 2013)
10.1	Seventh Amendment to Convertible Secured Subordinated Note Purchase Agreement and Fifth Amendment to Convertible Secured Subordinated Promissory Notes, dated May 12, 2014, by and among Moble Smith, Inc., Grasford Investments Ltd. and Crystal Management Ltd. (Filed herewith)
31.1	Certification of Principal Executive Officer Pursuant to Rule 13a-14(a) (Filed herewith)
31.2	Certification of Principal Financial Officer Pursuant to Rule 13a-14(a) (Filed herewith)
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 (Furnished herewith)
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 (Furnished herewith)
101.1	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Balance Sheets, (ii) the Condensed Statements of Operations, (iii) the Condensed Statements of Cash Flows, (iv) the Statement of Stockholders' Deficit and (v) related notes to these financial statements, tagged as blocks of text and in detail (Filed herewith)

SIGNATURES

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

MOBILESMITH, INC.

May 15, 2014	By: /s/ Amir Elbaz Amir Elbaz Chief Executive Officer
May 15, 2014	By: /s/ Gleb Mikhailov Gleb Mikhailov Chief Financial Officer

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a deterioration in credit of the issuer we apply an impairment model, including an anticipated recovery period, similar to a debt security. For equity securities we measure impairment charges based upon the difference between the book value of a security and its fair value.

Approximately 73% of the unrealized losses on fixed maturity securities shown in the above table for June 30, 2010 are on securities that are rated investment grade, defined as being the highest two NAIC designations. Approximately 27% of the unrealized losses on fixed maturity securities shown in the above table for June 30, 2010 are on securities rated below investment grade. All of the securities with unrealized losses are current with respect to the payment of principal and interest.

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The amortized cost and fair value of fixed maturity securities and equity securities in an unrealized loss position and the number of months in an unrealized loss position with fixed maturity securities that carry an NRSRO rating of BBB/Baa or higher considered investment grade were as follows:

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
June 30, 2010				
Fixed maturity securities:				
Investment grade:				
Less than six months	38	$ 281,017	$ 269,401	$ (11,616)
Six months or more and less than twelve months	9	104,636	99,706	(4,930)
Twelve months or greater	61	561,585	513,179	(48,406)
Total investment grade	108	947,238	882,286	(64,952)
Below investment grade:				
Less than six months	4	93,719	91,794	(1,925)
Six months or more and less than twelve months	1	36,447	34,806	(1,641)
Twelve months or greater	91	1,199,320	953,353	(245,967)
Total below investment grade	96	1,329,486	1,079,953	(249,533)
Equity securities:				
Less then six months	5	15,984	14,911	(1,073)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	7	23,000	20,566	(2,434)
Total equity securities	12	38,984	35,477	(3,507)
	216	$ 2,315,708	$ 1,997,716	$ (317,992)
December 31, 2009				
Fixed maturity securities:				
Investment grade:				
Less than six months	120	$ 2,516,264	$ 2,463,732	$ (52,532)
Six months or more and less than twelve months	26	1,591,620	1,500,847	(90,773)
Twelve months or greater	95	883,552	777,079	(106,473)
Total investment grade	241	4,991,436	4,741,658	(249,778)
Below investment grade:				
Less than six months	3	60,580	57,220	(3,360)
	12	85,605	64,159	(21,446)

Six months or more and less than twelve months				
Twelve months or greater	85	1,206,684	934,453	(272,231)
Total below investment grade	100	1,352,869	1,055,832	(297,037)
Equity securities:				
Less then six months	2	7,291	7,242	(49)
Six months or more and less than twelve months	1	2,658	2,560	(98)
Twelve months or greater	11	31,999	28,877	(3,122)
Total equity securities	14	41,948	38,679	(3,269)
	355	$ 6,386,253	$ 5,836,169	$ (550,084)

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The amortized cost and fair value of fixed maturity securities (excluding United States Government and United States Government sponsored agency securities) segregated by investment grade (NRSRO rating of BBB/Baa or higher) and below investment grade and equity securities that had unrealized losses greater than 20% and the number of months in an unrealized loss position greater than 20% were as follows:

	Number of Securities	Amortized Cost	Fair Value	Gross Unrealized Losses
		(Dollars in thousands)		
June 30, 2010				
Investment grade:				
Less than six months	—	$ —	$ —	$ —
Six months or more and less than twelve months	1	1,471	984	(486)
Twelve months or greater	2	7,302	5,449	(1,852)
Total investment grade	3	8,773	6,433	(2,338)
Below investment grade:				
Less than six months	1	2,250	1,737	(513)
Six months or more and less than twelve months	2	13,270	9,752	(3,518)
Twelve months or greater	10	165,110	106,581	(58,529)
Total below investment grade	13	180,630	118,070	(62,560)
	16	$ 189,403	$ 124,503	$ (64,898)
December 31, 2009				
Investment grade:				
Less than six months	2	$ 34,271	$ 30,198	$ (4,073)
Six months or more and less than twelve months	—	—	—	—
Twelve months or greater	2	11,940	8,601	(3,339)
Total investment grade	4	46,211	38,799	(7,412)
Below investment grade:				
Less than six months	13	118,198	101,805	(16,393)
Six months or more and less than twelve months	9	158,359	111,878	(46,481)
Twelve months or greater	27	365,706	252,062	(113,644)
Total below investment grade	49	642,263	465,745	(176,518)
	53	$ 688,474	$ 504,544	$ (183,930)

The amortized cost and fair value of fixed maturity securities, by contractual maturity, that were in an unrealized loss position are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our residential mortgage backed securities provide for periodic payments throughout their lives, and are shown below as a separate line.

	Available for sale		Held for investment	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
June 30, 2010				
Due in one year or less	$ —	$ —	$ —	$ —
Due after one year through five years	31,555	30,028	—	—
Due after five years through ten years	67,924	65,076	—	—
Due after ten years through twenty years	105,083	94,566	—	—
Due after twenty years	447,785	410,218	75,716	43,523
	652,347	599,888	75,716	43,523
Residential mortgage backed securities	1,548,661	1,318,828	—	—
	$ 2,201,008	$ 1,918,716	$ 75,716	$ 43,523
December 31, 2009				
Due in one year or less	$ 12,000	$ 11,707	$ —	$ —
Due after one year through five years	82,754	75,462	—	—
Due after five years through ten years	100,597	95,678	—	—
Due after ten years through twenty years	707,824	682,247	365,000	359,100
Due after twenty years	3,281,000	3,113,504	75,649	46,683
	4,184,175	3,978,598	440,649	405,783
Residential mortgage backed securities	1,719,481	1,413,109	—	—
	$ 5,903,656	$ 5,391,707	$ 440,649	$ 405,783

Watch List

At each balance sheet date, we identify invested assets which have characteristics (i.e. significant unrealized losses compared to amortized cost and industry trends) creating uncertainty as to our future assessment of an other than temporary impairment. As part of this assessment we review not only a change in current price relative to its amortized cost but the issuer's current credit rating and the probability of full recovery of principal based upon the

issuer's financial strength. Specifically for corporate issues we evaluate the financial stability and quality of asset coverage for the securities relative to the term to maturity for the issues we own. A security which has a 25% or greater change in market price relative to its amortized cost and a possibility of a loss of principal will be included on a list which is referred to as our watch list. We exclude from this list securities with unrealized losses which are related to market movements in interest rates and which have no factors indicating that such unrealized losses may be other than temporary as we do not intend to sell these securities and it is more likely than not we will not have to sell these securities before a recovery is realized. In addition, we exclude our RMBS as we monitor all of our RMBS on a quarterly basis for changes in default rates, loss severities and expected cash flows for the purpose of assessing potential other than temporary impairments and related credit losses to be recognized in operations. At June 30, 2010, the amortized cost and fair value of securities on the watch list are as follows:

General Description	Number of Securities	Amortized Cost	Unrealized Gains/ (Losses)	Fair Value	Months in Continuous Unrealized Loss Position	Months Unrealized Losses Greater Than 20%
		(Dollars in thousands)				
Investment grade						
Corporate fixed maturity securities:						
Insurance	1	$ 3,763	$ (1,044)	$ 2,719	32	25
Below investment grade						
Corporate fixed maturity securities:						
Finance and insurance	2	7,221	(1,478)	5,743	26-39	0-2
Retail	1	10,484	(1,746)	8,738	61	—
	3	17,705	(3,224)	14,481		
	4	$ 21,468	$ (4,268)	$ 17,200		

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Our analysis of these securities that we have determined are temporarily impaired and their credit performance at June 30, 2010 is as follows:

Finance and Insurance: The decline in value of these securities is due to the continued wide spreads as a result of the ongoing concerns relating to capital, asset quality and earnings stability due to the financial events of the past two years. While these issuers have had their financial position and profitability weakened by the credit and liquidity crisis, we have determined that these securities were not other than temporarily impaired due to our evaluation of the operating performance and the credit worthiness of each individual issuer.

Retail: The decline in value of this bond relates to a debt-financed share repurchase combined with a weakening economy which has led to a decrease in sales. We have determined that this security was not other than temporarily impaired due to the issuer's very strong market position and a consistent history of strong operating performance, improving economic conditions and rising security prices.

The securities on the watch list are current with respect to payments of principal and interest. We do not intend to sell these securities and it is more likely than not we will not have to sell these securities before recovery of their amortized cost and, as such, there were no other than temporary impairments on these securities at June 30, 2010.

Other Than Temporary Impairments

We have a policy and process in place to identify securities in our investment portfolio for which we should recognize impairments. See Critical Accounting Policies—Evaluation of Other Than Temporary Impairments included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009.

We recognized other than temporary impairments and additional credit losses on a number of securities for which we have previously recognized OTTI as follows:

General Description	Number of Securities	Total OTTI Losses	Portion of OTTI Losses in Other Comprehensive Income	Net OTTI Losses in Operations
		(Dollars in thousands)		
Three months ended June 30, 2010				
Residential mortgage backed securities	2	$ (1,603)	$ 785	(818)
Three months ended June 30, 2009				
Corporate securities:				
Finance	2	(4,186)	152	(4,034)
Insurance	1	(336)	48	(288)
Residential mortgage backed securities	7	(17,539)	16,218	(1,321)
	10	$ (22,061)	$ 16,418	$ (5,643)

Six months ended June 30, 2010								
Residential mortgage backed securities	6	$ (14,187	)	$ 10,146		(4,041	)
Six months ended June 30, 2009							
United States Government full faith and credit	1	$ (245	)	$ —		(245	)
Corporate securities:							
Finance	2	(4,769	)	735		(4,034	)
Insurance	2	(766	)	(420	)	(1,186	)
Home building	2	(420	)	(118	)	(538	)
Residential mortgage backed securities	17	(61,742	)	58,174		(3,568	)
Preferred stocks:							
Finance	6	(8,110	)	—		(8,110	)
Insurance	—	—		—		—	
Real estate	2	(1,400	)	—		(1,400	)
	32	$ (77,452	)	$ 58,371		$ (19,081	)

Several factors have led us to believe that full recovery of amortized cost will not be expected. These include, but are not limited to: (i) a significant change in the operating performance of a company; (ii) a material change in the expected contractual obligation of an issuer; (iii) a significant change in ratings as defined by the NRSRO; and (iv) the time frame in which a recovery to amortized cost may occur.

Deterioration of the issuers' credit worthiness and liquidity profile were major factors in leading us to make the determination that other than temporary impairments were present in our corporate bonds and preferred stocks. Our analysis demonstrated that we could not expect a recovery of our cost basis within our expected holding period for debt securities or within a reasonable period of time for equity securities.

In the case of residential mortgage backed securities, we considered the ratings downgrades, increased default and loss severity projections, actual defaults, and expected cash flow projections to determine that other than temporary impairments were present. We continue to monitor the cash flows and economics surrounding these securities to determine changes in expected future cash flows. The following table presents the range of significant assumptions used to determine the credit loss component of other than temporary impairments we have recognized on residential mortgage backed securities for the six months ended June 30, 2010 and 2009 which are all senior level tranches within the structure of the securities:

		Discount Rate				Default Rate				Loss Severity			
Sector	Vintage	Min		Max		Min		Max		Min		Max	
June 30, 2010													
Prime	2005	7.5	%	7.5	%	11	%	11	%	45	%	45	%
	2006	7.3	%	7.3	%	11	%	11	%	45	%	45	%
	2007	5.8	%	5.8	%	19	%	19	%	50	%	50	%
Alt-A	2005	6.8	%	7.4	%	12	%	26	%	45	%	50	%
	2007	7.0	%	7.0	%	45	%	45	%	57	%	57	%
June 30, 2009													
Prime	2006	6.6	%	7.3	%	9	%	9	%	40	%	40	%
	2007	6.2	%	6.7	%	9	%	12	%	35	%	50	%
Alt-A	2005	6.1	%	6.6	%	11	%	13	%	40	%	40	%
	2006	6.0	%	6.0	%	16	%	16	%	40	%	40	%
	2007	6.4	%	7.5	%	19	%	40	%	45	%	50	%

In making the decisions to write down the securities described above, we considered whether the factors leading to those write downs impacted any other securities held in our portfolio. In cases where we determined that a decline in value was related to an industry-wide concern, we considered the impact of such concern on all securities we held within that industry classification.

The following table is a summary of securities that are a part of our investment portfolio and for which at any time during our holding period we have recognized OTTI and the activity since recognizing OTTI:

	Number of Securities	Amortized Cost Prior to OTTI	OTTI Recognized in Operations	Return of Principal Since OTTI was Recognized	Premium Amortization/ Discount Accretion Since OTTI was Recognized	Amortized Cost
		(Dollars in thousands)				
June 30, 2010						
Corporate fixed maturity	5	$ 31,855	$ (22,461)	$ —	$ (384)	$ 9,010

securities						
Residential mortgage backed securities	58	980,177	(59,501)	(17,555)	731	903,852
Equity securities:						
Finance, insurance and real estate	15	100,481	(69,377)	(1,272)	—	29,832
	78	$ 1,112,513	$ (151,339)	$ (18,827)	$ 347	$ 942,694
December 31, 2009						
Corporate fixed maturity securities	7	$ 48,610	$ (22,425)	$ (247)	$ (335)	$ 25,603
Residential mortgage backed securities	55	869,653	(55,461)	(4,752)	192	809,632
Equity securities:						
Finance, insurance and real estate	18	110,481	(75,020)	(816)	—	34,645
	80	$ 1,028,744	$ (152,906)	$ (5,815)	$ (143)	$ 869,880

The following table summarizes the cumulative noncredit portion of OTTI and the change in fair value since recognition of OTTI, both of which were recognized in other comprehensive income, by major type of security for securities that are part of our investment portfolio:

	Amortized Cost	OTTI Recognized in Other Comprehensive Income	Change in Fair Value Since OTTI was Recognized	Fair Value
	(Dollars in thousands)			
June 30, 2010				
Corporate fixed maturity securities	$ 9,010	$ (3,251)	$ 7,176	$ 12,935
Residential mortgage backed securities	903,852	(215,391)	46,369	734,830
Equity securities:				
Finance, insurance and real estate	29,832	$ —	$ 9,763	$ 39,595
	$ 942,694	$ (218,642)	$ 63,308	$ 787,360
December 31, 2009				
Corporate fixed maturity securities	$ 25,603	$ (9,488)	$ 7,763	$ 23,878
Residential mortgage backed securities	809,632	(205,245)	11,809	616,196
Equity securities:				
Finance, insurance and real estate	34,645	—	13,045	47,690
	$ 869,880	$ (214,733)	$ 32,617	$ 687,764

Mortgage Loans on Real Estate

Our commercial mortgage loan portfolio consists of mortgage loans collateralized by the related properties and diversified as to property type, location, and loan size. Our mortgage lending policies establish limits on the amount that can be loaned to one borrower and other criteria to attempt to reduce the risk of default. Our commercial mortgage loans on real estate are reported at cost, adjusted for amortization of premiums and accrual of discounts net of valuation allowances. At June 30, 2010 and December 31, 2009 the largest principal amount outstanding for any single mortgage loan was $10.9 million and $11.2 million, respectively, and the average loan size was $2.4 million for both periods. We have the contractual ability to pursue full personal recourse on 13.5% of the loans and partial personal recourse on 32.3% of the loans, and master leases provide us recourse against the principals of the borrowing entity on 4.7% of the loans. In addition, the average loan to value ratio for the overall portfolio was 55.2% and 56.3% at June 30, 2010 and December 31, 2009, respectively, based upon the underwriting and appraisal at the time the loan was made. This loan to value is indicative of our conservative underwriting policies and practices for making commercial mortgage loans and may not be indicative of collateral values at the current reporting date. Our current practice is to only obtain market value appraisals of the underlying collateral at the inception of the loan unless we identify indicators of impairment in our ongoing analysis of the portfolio, in which case, we may obtain a current appraisal of the underlying collateral. The commercial mortgage loan portfolio is summarized by geographic region and property type as follows:

	June 30, 2010			December 31, 2009		
	Carrying Amount	Percent		Carrying Amount	Percent	
	(Dollars in thousands)					
Geographic distribution						
East	$ 573,476	22.7	%	$ 555,294	22.7	%
Middle Atlantic	169,462	6.7	%	168,246	6.9	%
Mountain	401,447	15.9	%	388,940	15.9	%
New England	43,609	1.7	%	44,541	1.8	%
Pacific	230,531	9.1	%	216,382	8.8	%
South Atlantic	498,355	19.8	%	463,773	18.9	%
West North Central	409,139	16.2	%	410,883	16.8	%
West South Central	199,413	7.9	%	201,719	8.2	%
	$ 2,525,432	100.0	%	$ 2,449,778	100.0	%
Loan loss allowance	(1,100)			—		
	2,524,332			2,449,778		
Property type distribution						
Office	$ 673,362	26.7	%	$ 664,397	27.1	%
Medical Office	159,434	6.3	%	145,390	5.9	%
Retail	582,467	23.1	%	564,023	23.0	%
Industrial/Warehouse	620,604	24.5	%	606,317	24.8	%
Hotel	148,999	5.9	%	155,594	6.4	%
Apartment	128,158	5.1	%	122,854	5.0	%
Mixed use/other	212,408	8.4	%	191,203	7.8	%

	$ 2,525,432	100.0	%	$ 2,449,778	100.0	%
Loan loss allowance	(1,100	)		—		
	2,524,332			2,449,778		

In the normal course of business, we commit to fund commercial mortgage loans up to 90 days in advance. At June 30, 2010, we had commitments to fund commercial mortgage loans totaling $32.8 million, with fixed interest rates ranging from 6.25% to 7.25%.

During the six months ended June 30, 2010, two of our mortgage loans were satisfied by taking ownership of the real estate serving as collateral on the loans. These loans had a total principal amount outstanding of $4.3 million, which is net of specific loan loss allowances totaling $0.5 million. No additional impairments were recognized when ownership of the real estate was taken as the fair value of the property less the estimated costs to sell exceeded the outstanding loan balance of the relative mortgage, net of any specific loan loss allowance established. We increased the allowance for credit losses on our mortgage loans by $1.1 million during the second quarter of 2010 and $5.2 million during six months ended June 30, 2010 and $1.0 million during the three and six months ended June 30, 2009.

At June 30, 2010, we have three mortgages that are in the process of being satisfied by our taking ownership of the real estate serving as collateral on the loan. These three loans have an outstanding principal balance of $6.9 million and we have recorded a specific loan loss allowances totaling $3.8 million in prior periods. We also have 23 commercial mortgage loans at June 30, 2010 with an outstanding principal balance of $61.3 million (2% of the commercial mortgage loan portfolio) that have been given "workout" terms which generally allow for interest only payments or the capitalization of interest for a specified period of time and we have recorded a specific loan loss allowance on one of these loans (principal balance of $5.7 million) of $1.0 million. At June 30, 2010, we have 9 commercial mortgage loans with an outstanding principal balance of $28.7 million that were delinquent in their principal and interest payments.

We evaluate our mortgage loan portfolio for the establishment of a loan loss reserve by specific identification of impaired loans and the measurement of an estimated loss for each individual loan identified and an analysis of the mortgage loan portfolio for the need for a general loan allowance for probable losses on all other loans. If we determine that the value of any specific mortgage loan is impaired, the carrying amount of the mortgage loan will be reduced to its fair value, based upon the present value of expected future cash flows from the loan discounted at the loan's effective interest rate, or the fair value of the underlying collateral. The amount of the general loan allowance is based upon management's evaluation of the collectability of the loan portfolio, historical loss experience, delinquencies, credit concentrations, underwriting standards and national and local economic conditions. Based upon this process and analysis, we established a general loan loss allowance of $1.1 million during the second quarter of 2010.

Mortgage loans summarized in the following table represent all loans that we are either not currently collecting or those we feel it is probable we will not collect all amounts due according to the contractual terms of the loan agreements (all loans that we have worked with the borrower to alleviate short-term cash flow issues and delinquent loans at the reporting date).

	June 30, 2010	December 31, 2009
	(Dollars in thousands)	
Mortgage loans with allowances	$ 20,353	$ 15,869
Mortgage loans with no allowance for losses	79,179	53,740
Allowance for probable loan losses	(9,957)	(5,266)
Net carrying value	$ 89,575	$ 64,343

Derivative Instruments

Our derivative instruments primarily consist of call options purchased to provide the income needed to fund the annual index credits on our fixed index annuity products. The fair value of the call options is based upon the amount of cash that would be required to settle the call options obtained from the counterparties adjusted for the nonperformance risk of the counterparty. The nonperformance risk for each counterparty is based upon its credit default swap rate. We have no performance obligations related to the call options.

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized

immediately in the consolidated statements of operations.

The fair value of our derivative instruments, including derivative instruments embedded in fixed index annuity contracts, presented in the unaudited consolidated balance sheets are as follows:

	June 30, 2010	December 31, 2009
	(Dollars in thousands)	
Assets		
Derivative Instruments		
Call options	$ 191,411	$ 479,272
Liabilities		
Policy benefit reserves - annuity products		
Fixed index annuities - embedded derivatives	$ 1,482,429	$ 1,375,866
Other liabilities		
Interest rate swaps	2,531	1,891
	$ 1,484,960	$ 1,377,757

The changes in fair value of derivatives included in the unaudited consolidated statements of operations are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Change in fair value of derivatives:				
Call options	$ (208,131)	$ 30,172	$ (124,829)	$ (13,102)
Interest rate swaps	(606)	322	(1,893)	(227)
	$ (208,737)	$ 30,494	$ (126,722)	$ (13,329)
Change in fair value of embedded derivatives:				
Fixed index annuities	$ 190,211	$ (140,716)	$ 126,336	$ (154,899)

We have fixed index annuity products that guarantee the return of principal to the policyholder and credit interest based on a percentage of the gain in a specified market index. When fixed index annuity deposits are received, a portion of the deposit is used to purchase derivatives consisting of call options on the applicable market indices to fund the index credits due to fixed index annuity policyholders. Substantially all such call options are one year options purchased to match the funding requirements of the underlying policies. The call options are marked to fair value with the change in fair value included as a component of revenues. The change in fair value of derivatives includes the gains or losses recognized at the expiration of the option term or upon early termination and the changes in fair value for open positions. On the respective anniversary dates of the index policies, the index used to compute the annual index credit is reset and we purchase new one-year call options to fund the next annual index credit. We manage the cost of these purchases through the terms of our fixed index annuities, which permit us to change caps, participation rates, and/or asset fees, subject to guaranteed minimums on each policy's anniversary date. By adjusting caps, participation rates, or asset fees, we can generally manage option costs except in cases where the contractual features would prevent further modifications.

Our strategy attempts to mitigate any potential risk of loss under these agreements through a regular monitoring process which evaluates the program's effectiveness. We do not purchase call options that would require payment or collateral to another institution and our call options do not contain counterparty credit-risk-related contingent features. We are exposed to risk of loss in the event of nonperformance by the counterparties and, accordingly, we purchase our option contracts from multiple counterparties and evaluate the creditworthiness of all counterparties prior to purchase of the contracts. All of these options have been purchased from nationally recognized financial institutions with a Standard and Poor's credit rating of A- or higher at the time of purchase and the maximum credit exposure to any single counterparty is subject to concentration limits. We also have credit support agreements with several counterparties that allow us to request the counterparty to provide collateral to us when the fair value of our exposure to the counterparty exceeds specified amounts.

The notional amount and fair value of our call options by counterparty and each counterparty's current credit rating are as follows:

		June 30, 2010		December 31, 2009	
Counterparty	Credit Rating	Notional Amount	Fair Value	Notional Amount	Fair Value
		(Dollars in thousands)			

Bank of America	A+	$ 559	$ —	$ 796	$ —
BNP Paribas	AA	1,198,608	39,002	1,647,627	101,888
Lehman	NR	—	—	1,437	—
Bank of New York	AA-	96,807	610	112,193	6,153
Credit Suisse	A+	2,113,201	29,432	2,711,027	163,321
Barclays	AA-	1,085,056	14,494	258,853	10,082
SunTrust	BBB+	252,281	6,868	427,572	27,735
Wells Fargo	AA	1,663,775	37,072	1,189,234	70,746
J.P. Morgan	AA-	2,616,441	56,158	1,648,394	99,347
UBS	A+	580,254	7,775	—	—
		$ 9,606,982	$ 191,411	$ 7,997,133	$ 479,272

As of June 30, 2010 and December 31, 2009, we held $101.7 million and $346.1 million, respectively, of cash and cash equivalents received from counterparties for derivative collateral, which is included in other liabilities on our consolidated balance sheets. This derivative collateral limits the maximum amount of loss due to credit risk that we would incur if parties to the call options failed completely to perform according to the terms of the contracts to $105.3 million and $149.5 million at June 30, 2010 and December 31, 2009, respectively.

We had unsecured counterparty exposure in connection with options purchased from affiliates of Lehman Brothers ("Lehman") which declared bankruptcy during the third quarter of 2008. All options purchased from affiliates of Lehman had expired as of June 30, 2010. The amount of option proceeds due on expired options which had been purchased from Lehman that we did not receive payment on was $6.5 million for the second quarter 2009 and $9.4 million for the six months ended June 30, 2009. No amount has been recognized for any recovery of these amounts that may result from our claim in Lehman's bankruptcy proceedings.

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Liquidity and Capital Resources

Our insurance subsidiaries continue to have adequate cash flows from annuity deposits and investment income to meet their policyholder and other obligations. Net cash flows from annuity deposits and funds returned to policyholders as surrenders, withdrawals and death claims were $946.3 million in the six months ended June 30, 2010 compared to $1.2 billion for the six months ended June 30, 2009, with the decrease attributable to a $162.5 million decrease in net annuity deposits after coinsurance and a $93.1 million (after coinsurance) increase in funds returned to policyholders. We continue to invest the net proceeds from policyholder transactions and investment activities in high quality fixed maturity securities and fixed rate commercial mortgage loans. As reported above under Financial Condition - Investments, during the second quarter of 2010 we experienced a significant amount of calls of United States Government sponsored agency securities and the accelerated pace of these calls is expected to continue in the second quarter of 2010. As a result we have had elevated levels of cash and cash equivalents during the first six months of 2010. We have been reinvesting the proceeds from the called securities in United States Government sponsored agencies, securities, investment grade corporate fixed maturity securities and United States municipalities, states and territories securities with yields that meet our investment spread objectives. Our ability to continue to reinvest the proceeds from called securities in assets with acceptable credit quality and yield characteristics similar to the called securities will be dependent on future market conditions.

We, as the parent company, are a legal entity separate and distinct from our subsidiaries, and have no business operations. Our assets consist primarily of the capital stock and surplus notes of our subsidiaries. Accordingly, our future cash flows depend upon the availability of dividends, surplus note interest payments and other statutorily permissible payments from our subsidiaries, such as payments under our investment advisory agreements and tax allocation agreement with our subsidiaries. The ability to pay such dividends and to make such other payments is limited by applicable laws and regulations of the states in which our subsidiaries are domiciled, which subject our subsidiaries to significant regulatory restrictions. These laws and regulations require, among other things, our insurance subsidiaries to maintain minimum solvency requirements and limit the amount of dividends these subsidiaries can pay. Along with solvency regulations, the primary driver in determining the amount of capital used for dividends is the level of capital needed to maintain desired financial strength ratings from A.M. Best. Given recent economic events that have affected the insurance industry, both regulators and rating agencies could become more conservative in their methodology and criteria, including increasing capital requirements for our insurance subsidiaries which, in turn, could negatively affect the cash available to us from insurance subsidiaries.

The statutory capital and surplus of our life insurance subsidiaries at June 30, 2010 was $1.3 billion. American Equity Investment Life Insurance Company (American Equity Life) made surplus note interest payments to us of $2.0 million during the six months ended June 30, 2010. For the remainder of 2010, up to $167.5 million can be distributed by American Equity Life as dividends under applicable laws and regulations without prior regulatory approval. Dividends may be made only out of earned surplus, and all surplus note payments are subject to prior approval by regulatory authorities. American Equity Life had $407.9 million of statutory earned surplus at June 30, 2010. The transfer of funds by American Equity Life is also restricted by a covenant in our revolving line of credit which requires American Equity Life to maintain a minimum risk-based capital ratio of 200%.

We have a $150 million line of credit which is fully drawn. In December 2009, we issued $115.8 million of convertible senior notes, of which $52.2 million was issued for cash. All of the cash proceeds from issuing these convertible senior notes are being used for working capital and general corporate purposes. We also have the ability to issue equity, debt or other types of securities through one or more methods of distribution under a currently effective shelf registration statement on Form S-3. The terms of any offering would be established at the time of the offering, subject to market conditions.

On August 20, 2009, we entered into distribution agreements with Fox-Pitt Kelton Cochran Caronia Waller (USA) LLC (“FPK”) and Sandler O’Neill & Partners, L.P. ("Sandler O'Neill"). On December 3, 2009, Macquarie Capital (USA) Inc. ("Macquarie Capital") assumed all of FPK's rights and obligations under our distribution agreement with FPK. Under the distribution agreements, we can offer and sell shares of our common stock up to an aggregate offering price of $50 million. From October 1, 2009 through June 30, 2010, we did not sell any shares of our common stock pursuant to these distribution agreements. From August 20, 2009 through September 30, 2009, we sold 132,300 shares of our common stock, resulting in gross proceeds to us of $1.1 million. On August 4, 2010, we provided notice to Macquarie Capital and Sandler O'Neill that we were terminating the distribution agreements.

New Accounting Pronouncements

In January 2010, the FASB issued an accounting standards update that expands the disclosure requirements related to fair value measurements. A reporting entity will be required to present on a gross basis rather than as one net number information about the purchases, sales, issuances and settlements of financial instruments that are categorized as Level 3 for fair value measurements. This guidance will be effective on January 1, 2011, and we do not expect the adoption to have a material impact on our consolidated financial statements.

In July 2010, FASB issued an accounting standards update that expands disclosures and provide users more transparency about allowances for credit losses and the credit quality of the financing receivables of an entity. This guidance requires additional disclosures about an entity's financing receivables, such as credit quality indicators, aging of past due financing receivables, and significant purchases and sales of financing receivables. In addition, disclosures must be disaggregated by portfolio segment or class based on how an entity develops its allowance for credit losses and how it manages its credit exposure. Most of the requirements are effective for the fourth quarter of 2010 with certain additional disclosures required for the first quarter of 2011. We are currently evaluating the impact of this guidance on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We seek to invest our available funds in a manner that will maximize shareholder value and fund future obligations to policyholders and debtors, subject to appropriate risk considerations. We seek to meet this objective through investments that: (i) consist predominately of investment grade fixed maturity securities; (ii) have projected returns which satisfy our spread targets; and (iii) have characteristics which support the underlying liabilities. Many of our products incorporate surrender charges, market interest rate adjustments or other features to encourage persistency.

We seek to maximize the total return on our available for sale investments through active investment management. Accordingly, we have determined that our available for sale portfolio of fixed maturity securities is available to be sold in response to: (i) changes in market interest rates; (ii) changes in relative values of individual securities and asset sectors; (iii) changes in prepayment risks; (iv) changes in credit quality outlook for certain securities; (v) liquidity needs: and (vi) other factors. An OTTI shall be considered to have occurred when we have an intention to sell available for sale securities in an unrealized loss position. If we do not intend to sell a debt security, we consider all available evidence to make an assessment of whether it is more likely than not that we will be required to sell the security before the recovery of its amortized cost basis. If it is more likely than not that we will be required to sell the security before recovery of its amortized cost basis, an OTTI will be considered to have occurred. We have a portfolio of held for investment securities which consists principally of long duration bonds issued by U.S. government agencies. These securities are purchased to secure long-term yields which meet our spread targets and support the underlying liabilities.

Interest rate risk is our primary market risk exposure. Substantial and sustained increases and decreases in market interest rates can affect the profitability of our products, the fair value of our investments, and the amount of interest we pay on our floating rate subordinated debentures. Our floating rate trust preferred securities issued by Trust III, IV, VII, VIII, IX, X, XI (beginning on December 31, 2010) and XII bear interest at the three month LIBOR plus 3.50% - 4.00%. Our outstanding balance of floating rate trust preferred securities was $144.5 million at June 30, 2010, of which $40 million had been swapped to fixed rates (see note 5 to our unaudited consolidated financial statements in Item 1 of this Form 10-Q). The applicable interest rate on our borrowings under our revolving line of credit is floating at LIBOR plus 0.80% or the greater of prime rate or federal funds rate plus 0.50%, as elected by us. In 2009, we swapped the floating interest rate to fixed rates for the $150 million of the borrowings outstanding on our revolving line of credit (see note 5 to our unaudited consolidated financial statements in Item 1 of this Form 10-Q). The profitability of most of our products depends on the spreads between interest yield on investments and rates credited on insurance liabilities. We have the ability to adjust crediting rates (caps, participation rates or asset fee rates for index annuities) on substantially all of our annuity liabilities at least annually (subject to minimum guaranteed values). In addition, substantially all of our annuity products have surrender and withdrawal penalty provisions designed to encourage persistency and to help ensure targeted spreads are earned. However, competitive factors, including the impact of the level of surrenders and withdrawals, may limit our ability to adjust or maintain crediting rates at levels necessary to avoid narrowing of spreads under certain market conditions.

A major component of our interest rate risk management program is structuring the investment portfolio with cash flow characteristics consistent with the cash flow characteristics of our insurance liabilities. We use computer models to simulate cash flows expected from our existing business under various interest rate scenarios. These simulations enable us to measure the potential gain or loss in fair value of our interest rate-sensitive financial instruments, to evaluate the adequacy of expected cash flows from our assets to meet the expected cash requirements of our liabilities and to determine if it is necessary to lengthen or shorten the average life and duration of our investment portfolio. The "duration" of a security is the time weighted present value of the security's expected cash flows and is used to measure a security's sensitivity to changes in interest rates. When the durations of assets and liabilities are similar, exposure to interest rate risk is minimized because a change in value of assets should be largely offset by a change in the value of liabilities.

If interest rates were to increase 10% (39 basis points) from levels at June 30, 2010, we estimate that the fair value of our fixed maturity securities would decrease by approximately $452.9 million. The impact on stockholders' equity of such decrease (net of income taxes and certain adjustments for changes in amortization of deferred policy acquisition costs and deferred sales inducements) would be a decrease of $96.9 million in the accumulated other comprehensive income and a decrease in stockholders' equity. The computer models used to estimate the impact of a 10% change in market interest rates incorporate numerous assumptions, require significant estimates and assume an immediate and parallel change in interest rates without any management of the investment portfolio in reaction to such change. Consequently, potential changes in value of our financial instruments indicated by the simulations will likely be different from the actual changes experienced under given interest rate scenarios, and the differences may be material. Because we actively manage our investments and liabilities, our net exposure to interest rates can vary over time. However, any such decreases in the fair value of our fixed maturity securities (unless related to credit concerns of the issuer requiring recognition of an other than temporary impairment) would generally be realized only if we were required to sell such securities at losses prior to their maturity to meet our liquidity needs, which we manage using the surrender and withdrawal provisions of our annuity contracts and through other means. See Financial Condition - Liquidity for Insurance Operations included in Management's Discussion and Analysis in our Annual Report on Form 10-K for the year ended December 31, 2009.

At June 30, 2010, 47% of our fixed income securities have call features and 4% were subject to call redemption. Another 22% will become subject to call redemption through December 31, 2010. During the six months ended June 30, 2010 and 2009, we received $2.4 billion and $3.2 billion, respectively, in redemption proceeds related to the exercise of such call options. We have reinvestment risk related to these redemptions to the extent we cannot reinvest the net proceeds in assets with credit quality and yield characteristics similar to the redeemed bonds. Such reinvestment risk typically occurs in a declining rate environment. Should rates decline to levels which tighten the spread between our average portfolio yield and average cost of interest credited on annuity liabilities, we have the ability to reduce crediting rates (caps, participation rates or asset fees for index annuities) on most of our annuity liabilities to maintain the spread at our targeted level. At June 30, 2010, approximately 99% of our annuity liabilities were subject to annual adjustment of the applicable crediting rates at our discretion, limited by minimum guaranteed crediting rates specified in the policies.

We purchase call options on the applicable indices to fund the annual index credits on our fixed index annuities. These options are primarily one-year instruments purchased to match the funding requirements of the underlying policies. Fair value changes associated with those investments are substantially offset by an increase or decrease in the amounts added to policyholder account balances for fixed index products. For the six months ended June 30, 2010 and 2009, the annual index credits to policyholders on their anniversaries were $295.5 million and $17.5 million, respectively. Proceeds received at expiration of these options related to such credits were $280.0 million and $5.0 million for the six months ended June 30, 2010 and 2009, respectively. The difference between proceeds received at expiration of these options and index credits is primarily due to credits attributable to minimum guaranteed interest self funded by us. Proceeds for the six months ended June 30, 2009 were adversely affected by $9.4 million in proceeds not received from affiliates of Lehman Brothers which declared bankruptcy in the third quarter of 2008.

Within our hedging process we purchase options out of the money to the extent of anticipated minimum guaranteed interest on index policies. On the anniversary dates of the index policies, we purchase new one-year call options to fund the next annual index credits. The risk associated with these prospective purchases is the uncertainty of the cost, which will determine whether we are able to earn our spread on our index business. We manage this risk through the terms of our fixed index annuities, which permit us to change caps, participation rates and asset fees, subject to contractual features. By modifying caps, participation rates or asset fees, we can limit option costs to budgeted amounts, except in cases where the contractual features would prevent further modifications. Based upon actuarial testing which we conduct as a part of the design of our index products and on an ongoing basis, we believe the risk that contractual features would prevent us from controlling option costs is not material.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with the Securities Exchange Act Rules 13a-15 and 15d-15, our management, under the supervision of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures were effective as of June 30, 2010 in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2010 have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are occasionally involved in litigation, both as a defendant and as a plaintiff. In addition, state regulatory bodies, such as state insurance departments, the Securities and Exchange Commission ("SEC"), the Financial Industry Regulatory Authority ("FINRA"), the Department of Labor, and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, the Employee Retirement Income Security Act of 1974, as amended, and laws governing the activities of broker-dealers.

In recent years, companies in the life insurance and annuity business have faced litigation, including class action lawsuits, alleging improper product design, improper sales practices and similar claims. We are currently a defendant in two purported class action lawsuits alleging improper sales practices and similar claims as described below. It is often not possible to determine the ultimate outcome of pending legal proceedings or to provide reasonable ranges of potential losses with any degree of certainty. The lawsuits referred to below are in pre-litigation and discovery stages and we do not have sufficient information to make an assessment of the plaintiffs' claims for liability or damages. The plaintiffs are seeking undefined amounts of damages or other relief, including punitive damages, which are difficult to quantify and cannot be estimated based on the information currently available. We do not believe that these lawsuits, including those discussed below, will have a material adverse effect on our financial position, results of operations or cash flows. However, there can be no assurance that such litigation, or any future litigation, will not have a material adverse effect on our business, financial condition, or results of operations.

We are a defendant in two cases, including (i) Stephens v. American Equity Investment Life Insurance Company, et. al., in the San Luis Obispo Superior Court, San Francisco, California (complaint filed November 29, 2004) (the "SLO Case") and (ii) McCormack, et al. v. American Equity Investment Life Insurance Company, et al., in the United States District Court for the Central District of California, Western Division and Anagnostis v. American Equity, et al., coordinated in the Central District, entitled, In Re: American Equity Annuity Practices and Sales Litigation, in the United States District Court for the Central District of California, Western Division (complaint filed September 7, 2005) (the "Los Angeles Case").

The plaintiffs in the SLO Case represent a class of individuals who are California residents and who either purchased their annuity from us through a co-defendant marketing organization or who purchased one of a defined set of particular annuities issued by us. The named plaintiffs in this case are: Chalys M. Stephens and John P. Stephens. Plaintiffs seek injunctive relief and restitution on behalf of all class members under California Business & Professions Code section 17200 et seq.; compensatory damages for breach of contract and breach of fiduciary duty; other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq.; and punitive damages under common law causes of action for fraud and breach of the covenant of good faith and fair dealing. We are vigorously defending the underlying allegations and may seek to decertify the entire class after further discovery into the merits of the case. Trial in this matter, originally scheduled for September 2010, has been re-scheduled for November 2010.

The Los Angeles Case is a consolidated action involving several lawsuits filed by individuals, and the individuals are seeking class action status for a national class of purchasers of annuities issued by us. The named plaintiffs in this consolidated case are Bernard McCormack, Gust Anagnostis by and through Gary S. Anagnostis and Robert C. Anagnostis, Regina Bush by and through Sharon Schipiour, Lenice Mathews by and through Mary Ann Maclean and George Miller. The allegations generally attack the suitability of sales of deferred annuity products to persons over the age of 65. The plaintiffs seek recessionary and injunctive relief including restitution and disgorgement of profits on behalf of all class members under California Business & Professions Code section 17200 et seq. and Racketeer

Influenced and Corrupt Organizations Act; compensatory damages for breach of fiduciary duty and aiding and abetting of breach of fiduciary duty; unjust enrichment and constructive trust; and other pecuniary damages under California Civil Code section 1750 and California Welfare & Institutions Codes section 15600 et seq. We are vigorously defending against both class action status as well as the underlying claims.

Item 1A. Risk Factors

Our 2009 Annual Report on Form 10-K described our Risk Factors. There have been no material changes to the Risk Factors during the six months ended June 30, 2010.

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

There were no issuer purchases of equity securities for the quarter ended June 30, 2010.

We have a Rabbi Trust, the NMO Deferred Compensation Trust, which purchases our common shares to fund the amount of shares earned by our agents under the NMO Deferred Compensation Plan. At June 30, 2010, agents had earned 81,745 shares which had vested but had not yet been purchased and contributed to the Rabbi Trust.

In addition, we have a share repurchase program under which we are authorized to purchase up to 10,000,000 shares of our common stock. As of June 30, 2010, we have repurchased 3,845,296 shares of our common stock under this program. We suspended the repurchase of our common stock under this program in August of 2008.

The maximum number of shares that may yet be purchased under these plans is 6,236,449 at June 30, 2010.

Item 6. Exhibits

(a) Exhibits:

12.1	Ratio of Earnings to Fixed Charges
31.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

Date: August 6, 2010	AMERICAN EQUITY INVESTMENT LIFE HOLDING COMPANY	
	By:	/s/ Wendy C. Waugaman Wendy C. Waugaman, President and Chief Executive Officer (Principal Executive Officer)
	By:	/s/ John M. Matovina John M. Matovina, Vice Chairman, Chief Financial Officer and Treasurer (Principal Financial Officer)
	By:	/s/ Ted M. Johnson Ted M. Johnson, Vice President - Controller (Principal Accounting Officer)

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