

NETWORK 1 TECHNOLOGIES INC  
Form 10-Q  
May 15, 2017

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U.S. SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2017

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

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

Commission File Number 1-15288

NETWORK-1 TECHNOLOGIES, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Delaware

11-3027591

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(State or Other Jurisdiction of Incorporation or Organization) (IRS Employer Identification No.)

445 Park Avenue, Suite 912  
New York, New York 10022

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(Address of Principal Executive Offices) (Zip Code)

212-829-5770  
(Registrant's Telephone Number)

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

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§223.405) of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of the registrant's common stock, \$.01 par value per share, outstanding as of May 8, 2017 was 24,329,954.

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NETWORK-1 TECHNOLOGIES, INC.

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## PART I. FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements

## NETWORK-1 TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)

	March 31, 2017	December 31, 2016
<b>ASSETS:</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$48,000,000	\$50,918,000
Marketable securities, available for sale	1,064,000	1,065,000
Royalty receivables, net	7,020,000	2,879,000
Prepaid taxes	241,000	1,195,000
Other current assets	57,000	83,000
<b>Total Current Assets</b>	<b>56,382,000</b>	<b>56,140,000</b>
<b>OTHER ASSETS:</b>		
Deferred tax assets	168,000	207,000
Patents, net of accumulated amortization	1,181,000	1,231,000
Security deposits	19,000	19,000
<b>Total Other Assets</b>	<b>1,368,000</b>	<b>1,457,000</b>
<b>TOTAL ASSETS</b>	<b>\$57,750,000</b>	<b>\$57,597,000</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY:</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$245,000	\$171,000
Accrued contingency fees and related costs	1,910,000	2,681,000
Accrued payroll	258,000	1,748,000
Other accrued expenses	149,000	125,000
<b>TOTAL LIABILITIES</b>	<b>2,562,000</b>	<b>4,725,000</b>

## COMMITMENTS AND CONTINGENCIES

## STOCKHOLDERS' EQUITY

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Preferred stock, \$0.01 par value, authorized 10,000,000 shares; none issued and outstanding at March 31, 2017 and December 31, 2016	—	—
Common stock, \$0.01 par value; authorized 50,000,000 shares; 24,329,954 and 23,744,829 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively	243,000	238,000
Additional paid-in capital	63,665,000	62,367,000
Accumulated deficit	(8,688,000 )	(9,702,000 )
Accumulated other comprehensive loss	(32,000 )	(31,000 )
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>55,188,000</b>	<b>52,872,000</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$57,750,000</b>	<b>\$57,597,000</b>

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

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## NETWORK-1 TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
(UNAUDITED)

	Three Months Ended March 31,	
	2017	2016
REVENUE	\$6,221,000	\$5,190,000
OPERATING EXPENSES:		
Costs of revenue	1,792,000	1,486,000
Professional fees and related costs	405,000	452,000
General and administrative	484,000	403,000
Amortization of patents	50,000	414,000
Stock-based compensation	237,000	12,000
TOTAL OPERATING EXPENSES	2,968,000	2,767,000
OPERATING INCOME	3,253,000	2,423,000
OTHER INCOME:		
Interest income, net	9,000	10,000
INCOME BEFORE INCOME TAXES	3,262,000	2,433,000
INCOME TAXES (BENEFIT):		
Current	955,000	51,000
Deferred taxes, net	39,000	(1,438,000 )
Total income taxes (benefit)	994,000	(1,387,000 )
NET INCOME	\$2,268,000	\$3,820,000
Net Income Per Share		
Basic	\$0.09	\$0.16
Diluted	\$0.09	\$0.16
Weighted average common shares outstanding:		
Basic	24,118,851	23,252,751
Diluted	26,333,945	24,266,573
Cash dividends declared per share	\$0.05	\$—
NET INCOME	\$2,268,000	\$3,820,000
OTHER COMPREHENSIVE INCOME:		
Unrealized holding gain (loss) on securities available-for-sale arising during the period	(1,000 )	27,000

COMPREHENSIVE INCOME	\$2,267,000	\$3,847,000
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The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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## NETWORK-1 TECHNOLOGIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Three Months Ended March 31,	
	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Income	\$2,268,000	\$3,820,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of patents	50,000	414,000
Stock-based compensation	237,000	12,000
Deferred tax provision	39,000	(1,438,000 )
Changes in operating assets and liabilities:		
Royalty receivables	(4,141,000 )	(3,665,000 )
Prepaid taxes	955,000	—
Other current assets	26,000	74,000
Accounts payable	74,000	124,000
Accrued expenses	(2,285,000 )	777,000
<b>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES</b>	<b>(2,777,000 )</b>	<b>118,000</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of patents	—	(2,000 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Cash dividends	(1,209,000 )	—
Value of shares delivered to fund withholding taxes on exercise of options	—	(44,000 )
Repurchases of common stock, net of commissions	—	(1,000 )
Proceeds from exercise of options and warrants	1,068,000	60,000
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>(141,000 )</b>	<b>15,000</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(2,918,000 )</b>	<b>131,000</b>
<b>CASH AND CASH EQUIVALENTS, beginning of period</b>	<b>50,918,000</b>	<b>20,608,000</b>
<b>CASH AND CASH EQUIVALENTS, end of period</b>	<b>\$48,000,000</b>	<b>\$20,739,000</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid during the period for:		
Interest	\$—	\$—
Income taxes	—	—
<b>NON-CASH FINANCING ACTIVITY</b>		

Accrued dividend rights on restricted stock units	\$47,000	\$—
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The accompanying notes are an integral part of the unaudited condensed consolidated financial statements

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NETWORK-1 TECHNOLOGIES, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A – BASIS OF PRESENTATION AND NATURE OF BUSINESS:

[1] BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements are unaudited, but, in the opinion of the management of Network-1 Technologies, Inc. (the "Company"), contain all adjustments consisting only of normal recurring items which the Company considers necessary for the fair presentation of the Company's financial position as of March 31, 2017, and the results of its operations and comprehensive income for the three month periods ended March 31, 2017 and March 31, 2016 and its cash flows for the three month periods ended March 31, 2017 and March 31, 2016. The unaudited condensed consolidated financial statements included herein have been prepared in accordance with the accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and the instructions to Form 10-Q and Regulation S-X. Accordingly, certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with U.S. GAAP may have been omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate to make the information presented not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2016 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 20, 2017. The results of operations for the three months ended March 31, 2017 are not necessarily indicative of the results of operations to be expected for the full year. The accompanying condensed consolidated financial statements include accounts of the Company and its wholly-owned subsidiary, Mirror Worlds Technologies, LLC.

[2] BUSINESS:

The Company is engaged in the development, licensing and protection of its intellectual property assets. The Company presently owns thirty-three (33) patents including (i) the remote power patent (the "Remote Power Patent") covering the delivery of power over Ethernet (PoE) cables for the purpose of remotely powering network devices, such as wireless access ports, IP phones and network based cameras; (ii) the Mirror Worlds patent portfolio (the "Mirror Worlds Patent Portfolio") relating to foundational technologies that enable unified search and indexing, displaying and archiving of documents in a computer system; (iii) the Cox patent portfolio (the "Cox Patent Portfolio") relating to enabling technology for identifying media content on the Internet and taking further action to be performed based on such identification; and (iv) patents covering systems and methods for the transmission of audio, video and data over computer and telephony networks in order to achieve high quality of service (QoS) (the "QoS Patents"). The Company has been actively engaged in licensing its Remote Power Patent (U.S. Patent No. 6,218,930) covering the control of power delivery over Ethernet cables. As of March 31, 2017, the Company has entered into twenty-four (24) license agreements with respect to its Remote Power Patent. The Company has also entered into two license agreements with respect to its Mirror Worlds Patent Portfolio. The Company's current strategy includes continuing to pursue licensing opportunities for its intellectual property assets. The Company's acquisition strategy is to focus on acquiring high quality patents which management believes have the potential to generate significant licensing opportunities as the Company has achieved with respect to its Remote Power Patent and Mirror Worlds Patent Portfolio. The Company's Remote Power Patent has generated licensing revenue in excess of \$111,000,000 from May 2007 through March 31, 2017. As a result of the Company's acquisition of the Mirror Worlds Patent Portfolio in May 2013, the Company achieved licensing and other revenue of \$47,150,000 through March 31, 2017. In addition, the Company may enter into strategic relationships with third parties to develop, commercialize, license or otherwise monetize their intellectual property.



NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates and Assumptions

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. The significant estimates and assumptions made in the preparation of the Company's unaudited condensed consolidated financial statements include revenue recognition, the valuation of warrants and stock-based compensation, current income taxes, valuation of patents, accrued expenses and valuation of marketable securities. Actual results could be materially different from those estimates, upon which the carrying values were based.

Patents

The Company owns patents that relate to various technologies. The Company capitalizes the costs associated with acquisition, registration and maintenance of its acquired patents and amortizes these assets over their remaining useful lives on a straight-line basis. Any further payments made to maintain or develop the patents would be capitalized and amortized over the balance of the useful life for the patents.

Revenue Recognition

The Company recognizes revenue received from the licensing of its intellectual property and other related intellectual property activities. Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been performed pursuant to the terms of the license or other applicable agreement, (iii) amounts are fixed or determinable, and (iv) collectability of amounts is reasonably assured. The Company relies on royalty reports received from third party licensees to record its revenue. From time to time the Company may audit royalties reported from licensees. Any adjusted royalty revenue as a result of such audits is recorded by the Company in the period in which such adjustment is agreed to by the Company and the licensee or otherwise determined.

Costs of Revenue

The Company includes in costs of revenue for the three months ended March 31, 2017 and 2016 contingent legal fees payable to patent litigation counsel (see Note H[1] hereof) and incentive bonus compensation payable to its Chairman and Chief Executive Officer (see Note I[1] hereof).

Income Taxes

The Company accounts for income taxes in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740, "Income Taxes" (ASC 740), which requires the Company to use the assets and liability method of accounting for income taxes. Under the assets and liability method, deferred income taxes are recognized for the tax consequences of temporary (timing) differences by applying enacted statutory tax rates applicable to future years to differences between financial statement carrying amounts and the tax bases of existing assets and liabilities and operating loss and tax credit carry forwards. Under this accounting standard, the effect on deferred income taxes of a change in tax rates is

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

recognized in income in the period that includes the enactment date. A valuation allowance is recognized if it is more likely than not that some portion, or all of, a deferred tax asset will not be realized.

ASC 740-10, "Accounting for Uncertainty in Income Taxes," defines uncertainty in income taxes and the evaluation of a tax position as a two-step process. The first step is to determine whether it is more likely than not that a tax position will be sustained upon examination, including the resolution of any related appeals or litigation based on the technical merits of that position. The second step is to measure a tax position that meets the more-likely-than-not threshold to determine the amount of benefit to be recognized in the financial statements. A tax position is measured at the largest amount of benefit that is greater than 50 percent likelihood of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent period in which the threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not criteria should be de-recognized in the first subsequent financial reporting period in which the threshold is no longer met. The Company has no uncertain tax positions as of March 31, 2017 and December 31, 2016.

United States federal, state and local income tax returns prior to 2013 are not subject to examination by any applicable tax authorities, except that tax authorities could challenge returns (only under certain circumstances) for earlier years to the extent they generated loss carry-forwards that are available for those future years.

Effective January 1, 2017, the Company adopted ASU 2016-09, Improvements to Employee Share Based Accounting, which impacts the Company's presentation of certain taxes. See "Accounting Standards Adopted in Period" section of this Note B for further details.

The personal holding company ("PHC") rules under the Internal Revenue Code impose a 20% tax on a PHC's undistributed personal holding company income ("PHC Income"), which means, in general, taxable income subject to certain adjustments. For a corporation to be classified as a PHC, it must satisfy two tests: (i) that more than 50% in value of its outstanding shares must be owned directly or indirectly by 5 or fewer individuals at anytime during the second half of the year (after applying constructive ownership rules to attribute stock owned by entities to their beneficial owners and among certain family members and other related parties) (the "Ownership Test") and (ii) at least 60% of its adjusted ordinary gross income for a taxable year consists of dividends, interest, royalties, annuities and rents (the "Income Test"). In the second half of 2016 (as well as prior years), the Company did not meet the Ownership Test. Due to the significant number of shares held by the Company's largest shareholders, the Company continually assesses its share ownership to determine whether it meets the Ownership Test. If the Ownership Test were met and the income generated by the Company were determined to constitute "royalties" within the meaning of the Income Test, the Company would constitute a PHC and the Company would be subject to a 20% tax on the amount of any PHC Income that it does not distribute to its shareholders.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of long-lived assets

Intangible assets with finite lives are tested for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. Accordingly, we record impairment losses on long-lived assets used in operations or expected to be disposed of when indicators of impairment exist and the undiscounted cash flows expected to be derived from those assets are less than carrying amounts of these assets. At March 31, 2017 and March 31, 2016, there was no impairment to the Company's patents.

Stock-Based Compensation

The Company accounts for its stock-based compensation awards to employees and directors in accordance with FASB ASC Topic 718, Compensation - Stock Compensation ("ASC 718"). ASC 718 requires all stock-based compensation to employees, including grants of employee stock options and restricted stock units, to be recognized in the unaudited condensed consolidated statements of income and comprehensive income based on their grant date fair values. Compensation expense related to awards to employees is recognized on a straight-line basis based on the grant date fair value over the associated service period of the award, which is generally the vesting term. Share-based compensation issued to non-employees are recorded at their fair values, and are periodically revalued as the equity instruments vest and are recognized as expense over the related service period and are expensed using an accelerated attribution model. The Company uses the Black-Scholes option pricing model to determine the grant date fair value of options granted. The fair value of restricted stock units is determined based on the number of shares granted and either the quoted market price of the Company's common stock on the date of grant for time-based and performance-based awards, or the fair value on the date of grant using the Monte Carlo Simulation model for market-based awards (see Note D hereof for further discussion of the Company's stock – based compensation).

Earnings Per Share

The Company reports earnings per share in accordance with U.S. GAAP, which requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts, such as warrants and options to purchase common stock were exercised and shares were issued pursuant to outstanding restricted stock units. Common stock equivalents having an anti-dilutive effect on earnings per share are excluded from the calculation of diluted earnings per share (see Note E hereof).

Financial Instruments

U.S. GAAP regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The three levels of inputs are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 inputs to the valuation methodology are unobservable.

The carrying value of cash, marketable securities, royalty receivables, other assets, accounts payable, and accrued expenses approximates fair value because of the short period of time between the origination of such instruments and their expected realization and their current market rates of interest. Marketable securities available for sale are measured at fair value on a recurring basis based on Level 1 inputs (see Note G hereof).

Dividends

Dividends are recorded when declared by the Company's Board of Directors. Common stock dividends are charged against retained earnings when declared or paid (see Note M hereof).

Recent Accounting Pronouncements

In August 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, which amends ASC 230, Statement of Cash Flows. This ASU provides guidance on the statement of cash flows presentation of certain transactions where diversity in practice exists. The guidance is effective for interim and annual periods beginning after December 15, 2017, and early adoption is permitted. The Company does not believe that the adoption of this ASU will have a material impact on its unaudited condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). ASU No. 2016-02 is effective for annual periods beginning after December 15, 2018, and requires a lessee to recognize assets and liabilities for leases with a maximum possible term of more than 12 months. A lessee would recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the leased asset (the underlying asset) for the lease term. Early application is permitted. The Company does not believe that the adoption of this accounting standard will have a material impact on its unaudited condensed consolidated financial statements.

In May 2014, FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 provides for a single comprehensive model for use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The new revenue standard allows for either full retrospective or modified retrospective application. The Company is required to adopt the amendments in ASU No. 2014-09 using one of the two acceptable methods. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which



## NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

deferred the effective date of ASU No. 2014-09 to annual periods beginning after December 2017, along with an option to permit early adoption as of the original effective date. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which amends the guidance in 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property. The ASU does not change the core principle of the guidance in Topic 606. In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, related to disclosures of remaining performance obligations, as well as other amendments to guidance on collectability, non-cash consideration and the presentation of sales and other similar taxes collected from customers. The effective date and transition requirements for the ASUs are the same as the effective date and transition requirements in Topic 606. Public entities should apply the ASUs for annual reporting periods beginning after December 15, 2017, including interim reporting periods therein (i.e., January 1, 2018, for a calendar year entity). Early application for public entities is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company expects to complete its assessment process, including identifying its performance obligations and selecting a transition method for adoption, by the end of the second quarter of 2017 along with its implementation process prior to the adoption of this ASU on January 1, 2018.

Accounting Standards Adopted in the Period

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends Accounting Standards Codification ("ASC") Topic 718, Compensation - Stock Compensation. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Prior to this amendment, excess tax benefits resulting from the difference between the deduction for tax purposes and the compensation costs recognized for financial reporting were not recognized until the deduction reduced taxes payable. Under the new method the Company will recognize excess tax benefits in the current accounting period. Additionally, ASU 2016-09 requires that the Company present excess tax benefits on the Statement of Cash Flows as an operating activity. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016. The Company adopted ASU 2016-09 in the first quarter of 2017 and elected to apply this adoption prospectively. Prior periods have not been adjusted. The effective tax rate for the three months ended March 31, 2017 differed from the Federal statutory rate primarily due to the recognition of excess tax benefits as a component of the provision for income taxes attributable to the adoption of ASU 2016-09.

## NOTE C - PATENTS

The Company's intangible assets at March 31, 2017 include patents with estimated remaining economic useful lives ranging from 3.5 to 4.5 years. For all periods presented, all of the Company's patents were subject to amortization. The gross carrying amounts and accumulated amortization related to acquired intangible assets as of March 31, 2017 and December 31, 2016 are as follows:

	March 31, 2017	December 31, 2016
Gross carrying amount – patents	\$6,427,000	\$6,427,000
Accumulated amortization – patents	(5,246,000)	(5,196,000)
Patents, net	\$1,181,000	\$1,231,000



## NOTE C – PATENTS (continued)

Amortization expense for the three months ended March 31, 2017 and March 31, 2016 was \$50,000 and \$414,000, respectively. Future amortization of current intangible assets, net is as follows:

<u>Twelve Months Ended March 31,</u>	
2018	\$200,000
2019	\$193,000
2020	\$193,000
2021	\$193,000
2022 and thereafter	\$402,000
Total	\$1,181,000

The Company's Remote Power Patent expires in March 2020. The expiration dates of the patents within the Company's Mirror Worlds Patent Portfolio range from August 2017 to February 2020 (six of the patents in the Mirror Worlds Patent Portfolio expired as of September 30, 2016). The expiration dates of the patents within the Cox Patent Portfolio range from September 2021 to November 2023 and the expiration date of the QoS Patents is June 2019.

## NOTE D – STOCK-BASED COMPENSATION

Restricted Stock Units

During the three months ended March 31, 2017, the Company issued 13,500 restricted stock units to each of its three non-management directors as an annual grant for 2017 for service on the Company's Board of Directors. Each restricted stock unit represents a contingent right to receive one share of the Company's common stock. The restricted stock units vest in four equal quarterly installments of 3,375 shares of common stock on March 15, 2017, June 15, 2017, September 15, 2017 and December 15, 2017, subject to continued service on the Board of Directors.

## NOTE D – STOCK-BASED COMPENSATION (continued)

A summary of restricted stock unit activity for the three months ended March 31, 2017 is as follows (each restricted stock unit represents the right to receive one share of the Company's common stock):

	Number of Shares	Weighted-Average Grant Date Fair Value
Balance of restricted stock units outstanding at December 31, 2016	890,000	\$ 2.29
Grants of restricted stock units	40,500	\$ 3.80
Vested restricted stock units	(10,125 )	\$ (3.80 )
Balance of unvested restricted stock units at March 31, 2017	920,375	\$ 2.34

Restricted stock unit compensation expense was \$237,000 for the three months ended March 31, 2017. There was no restricted stock unit compensation expense for the three months ended March 31, 2016.

The Company has an aggregate of \$1,572,000 of unrecognized restricted stock unit compensation expense as of March 31, 2017 to be expensed over a weighted average period of 2.1 years.

All of the Company's 920,375 outstanding restricted stock units have dividend equivalent rights.

Stock Options

There were no stock option grants during the three months ended March 31, 2017 and March 31, 2016.

The following table presents information relating to all stock options outstanding and exercisable at March 31, 2017:

Range of Exercise Price	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Life in Years	Options Exercisable
\$0.83 - \$2.34	2,110,000	\$1.28	2.75	2,110,000

The Company recorded stock-based compensation related to stock option grants of \$0 and \$12,000 for the three months ended March 31, 2017 and March 31, 2016, respectively.

The Company had no unrecognized stock-based compensation cost as of March 31, 2017. The aggregate intrinsic value of options exercisable at March 31, 2017 was \$7,541,050.

During the three months ended March 31, 2017, the Company's Chief Financial Officer and three of his children exercised stock options to purchase an aggregate of 75,000 shares of the Company's common stock at an exercise price of \$1.40 per share. In addition, during the three months ended March 31, 2017, a former director exercised a stock option to purchase 125,000 shares of the Company's common stock at an exercise price of \$1.40 per share.

During the three months ended March 31, 2016, the Company's Chief Financial Officer and Executive Vice President exercised stock options to purchase 100,000 shares of the Company's



## NOTE D – STOCK-BASED COMPENSATION (continued)

common stock, at an exercise price of \$1.59 per share, and 240,000 shares of common stock, at an exercise price of \$1.60 per share, respectively. The options were exercised on a partial cashless (net exercise) basis by delivery to the Company of an aggregate of 249,820 shares of the Company's common stock (Chief Financial Officer – 50,857 shares and Executive Vice President - 198,963 shares) and \$55,250. In addition, an aggregate of 22,655 shares and \$6,045 (Chief Financial Officer – 5,563 shares and \$6,045 and Executive Vice President – 17,092 shares) were delivered to fund payroll withholding taxes on exercise, resulting in net shares of 43,580 and 23,944 issued to the Chief Financial Officer and Executive Vice President, respectively, with respect to such option exercises. In addition, during the three months ended March 31, 2016, a consultant to the Company exercised a stock option to purchase 90,000 shares of the Company's common stock, at an exercise price of \$1.60 per share. Such option was exercised on a cashless (net exercise) basis by delivery to the Company of 72,727 shares of common stock resulting in 17,273 net shares issued to the consultant with respect to such option exercise.

Warrants

As of March 31, 2017, there were no outstanding warrants to purchase shares of the Company's common stock.

During the three months ended March 31, 2017, Recognition Interface, LLC exercised its remaining warrants to purchase an aggregate of 375,000 shares of the Company's common stock, at an exercise price of \$2.10 per share, which resulted in gross proceeds to the Company of \$787,500.

## NOTE E – EARNINGS PER SHARE

Basic Earnings per share is calculated by dividing the net income by the weighted average number of outstanding common shares during the period. Diluted per share data includes the dilutive effects of options, warrants and restricted stock units. Potential shares of 3,030,375 and 3,160,000 at March 31, 2017 and March 31, 2016, respectively, consisted of options, warrants and restricted stock units. Computations of basic and diluted weighted average common shares outstanding are as follows:

	Three Months Ended March 31,	
	2017	2016
Weighted-average common shares outstanding – basic	24,118,851	23,252,751
Dilutive effect of options, warrants and restricted stock units	2,215,094	1,013,822
Weighted-average common shares outstanding – diluted	26,333,945	24,266,573
Options, warrants and restricted stock units excluded from the computation of diluted income per share because the effect of inclusion would have been anti-dilutive	250,000	480,000

## NOTE F – CASH AND CASH EQUIVALENTS

The Company places cash investments in high quality financial institutions insured by the Federal Deposit Insurance Corporation ("FDIC"). At March 31, 2017, the Company maintained a cash balance of \$47,219,000 in excess of FDIC limits.

The Company considers all highly liquid short-term investments purchased with an original maturity of three months or less to be cash equivalents.

Cash and cash equivalents as of March 31, 2017 and December 31, 2016 are composed of:

	March 31, 2017	December 31, 2016
Cash	\$7,944,000	\$9,452,000
Money market fund	40,056,000	41,466,000
Total	\$48,000,000	\$50,918,000

## NOTE G - MARKETABLE SECURITIES

Marketable securities are classified as available-for-sale and are recorded at fair market value. Unrealized gains and losses are reported as other comprehensive income or loss. Realized gains and losses are reclassified from other comprehensive income or loss to net income or loss in the period they are realized. At March 31, 2017 and December 31, 2016, the Company's marketable securities consisted of two corporate bonds (aggregate face value \$1,000,000) with a 3.9% and 4.5% coupon and term of greater than three months when purchased. The Company's marketable securities mature in 2021 and it is not the intention of the Company to hold such securities until maturity.

## NOTE H – COMMITMENTS AND CONTINGENCIES

## [1] Legal Fees:

Russ, August & Kabat provides legal services to the Company with respect to its pending patent litigation filed in May 2017 against Facebook, Inc. in the United States District Court for the Southern District of New York relating to several patents within the Company's Mirror Worlds Patent Portfolio (see Note N hereof). The terms of the Company's agreement with Russ, August & Kabat provide for cash payments on a monthly basis subject to a cap plus a contingency fee ranging between 15% and 24% of the net recovery (after deduction of expenses) depending on the stage of the proceeding in which the result (settlement or judgment) is achieved. The Company is responsible for all of the expenses incurred with respect to this litigation.

Russ, August & Kabat provides legal services to the Company with respect to its pending patent litigations filed in April 2014 and December 2014 against Google Inc. and YouTube, LLC in the United States District Court for the Southern District of New York relating to certain patents within the Company's Cox Patent Portfolio (see Note J[3] hereof). The terms of the Company's agreement with Russ, August & Kabat provides for legal fees on a full contingency basis ranging from 15% to 30% of the net recovery (after deduction of expenses) depending on the stage of the proceeding in which the result (settlement or judgment) is achieved. The Company is responsible for all of the

expenses incurred with respect to this litigation.

Dovel & Luner, LLP provides legal services to the Company with respect to its patent litigation filed in September 2011 against sixteen (16) data networking equipment manufacturers in the United States District Court for the Eastern District of Texas, Tyler (see Note J[1] hereof). The

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NOTE H – COMMITMENTS AND CONTINGENCIES (continued)

terms of the Company's agreement with Dovel & Luner LLP essentially provide for legal fees on a full contingency basis ranging from 12.5% to 35% (with certain exceptions) of the net recovery (after deduction for expenses) depending on the stage of the proceeding in which a result (settlement or judgment) is achieved. For the three months ended March 31, 2017 and March 31, 2016, the Company incurred aggregate contingent legal fees with respect to the litigation of \$284,000 and \$52,000, respectively, to Dovel & Luner, LLP. The Company is responsible for a certain portion of the expenses incurred with respect to the litigation.

Dovel & Luner, LLP provided legal services to the Company with respect to the litigation settled in July 2010 against Cisco and several other major data networking equipment manufacturers (see Note J[2] hereof). The terms of the Company's agreement with Dovel & Luner, LLP with respect to this litigation provided for legal fees of a maximum aggregate cash payment of \$1.5 million plus a contingency fee of 24% (based on the settlement being achieved at the trial stage). As a result of the royalty payments payable quarterly by Cisco in accordance with the Company's settlement and license agreement with Cisco, the Company has an obligation to pay Dovel & Luner, LLP (including local counsel) 24% of such royalties received. During the three months ended March 31, 2017 and March 31, 2016, the Company incurred aggregate legal fees to Dovel & Luner LLP of \$1,189,000 and \$1,164,000, respectively, with respect to the litigation.

[2] Patent Acquisitions:

On February 28, 2013, the Company completed the acquisition of four patents (as well as a pending patent application) from Dr. Ingemar Cox (these patents together with subsequent related patent issuances comprise the Cox Patent Portfolio), a technology leader in digital watermarking content identification, digital rights management and related technologies, for a purchase price of \$1,000,000 in cash and 403,226 shares of the Company's common stock. In addition, the Company is obligated to pay Dr. Cox 12.5% of the net proceeds (after deduction of expenses) generated by the Company from licensing, sale or enforcement of the patents. Since the acquisition of the patent portfolio from Dr. Cox, the Company has been issued thirteen (13) additional related patents by the USPTO resulting in an aggregate of seventeen (17) patents within the Cox Patent Portfolio. Professional fees and filing fees of \$169,000 were capitalized as patent cost.

On May 21, 2013, the Company's wholly-owned subsidiary, Mirror Worlds Technologies, LLC, acquired all of the patents previously owned by Mirror Worlds, LLC (which subsequently changed its name to Looking Glass LLC ("Looking Glass")), consisting of nine issued United States patents and five pending applications covering foundational technologies that enable unified search and indexing, displaying and archiving of documents in a computer system (these patents together with subsequent related patent issuances comprise the Mirror Worlds Patent Portfolio). As consideration for the patent acquisition, the Company paid Looking Glass \$3,000,000 in cash, and issued 5-year warrants to purchase an aggregate of 1,750,000 shares of the Company's common stock (875,000 shares of common stock at an exercise price of \$1.40 per share and 875,000 shares of common stock at an exercise price of \$2.10 per share) (the "Looking Glass Warrants"). On June 3, 2014, the Company repurchased the Looking Glass Warrants from Looking Glass at a cost of \$505,000.

NOTE H – COMMITMENTS AND CONTINGENCIES (continued)

As part of the acquisition of the Mirror Worlds Patent Portfolio, the Company also entered into an agreement with Recognition Interface, LLC ("Recognition"), an entity that financed the commercialization of the patent portfolio prior to its sale to Mirror Worlds, LLC and also retained an interest in the licensing proceeds of the patent portfolio held by Mirror Worlds, LLC. Pursuant to the terms of the Company's agreement with Recognition, Recognition received (i) 5-year warrants to purchase 250,000 shares of the Company's common stock at an exercise price of \$1.40 per share, and (ii) 5-year warrants to purchase 250,000 shares of common stock at an exercise price of \$2.10 per share. Recognition also received from the Company an interest in the net proceeds realized from the monetization of the Mirror Worlds Patent Portfolio, as follows: (i) 10% of the first \$125 million of net proceeds; (ii) 15% of the next \$125 million of net proceeds; and (iii) 20% of any portion of the net proceeds in excess of \$250 million. Since entering into the agreement with Recognition in May 2013, the Company has paid Recognition an aggregate of \$3,127,000 with respect to such net proceeds interest related to the Mirror Worlds Patent Portfolio. In addition, Abacus and Associates, Inc. ("Abacus"), an entity affiliated with Recognition, received a 60-day warrant to purchase 500,000 shares of the Company's common stock at an exercise price of \$2.05 per share. In accordance with the Company's agreement with Recognition, as a result of the exercise of the 60-day warrant by Abacus in July 2013, additional 5-year warrants to purchase an aggregate of 250,000 shares of the Company's common stock were issued to Recognition (125,000 shares at an exercise price of \$2.10 per share and 125,000 shares at an exercise price of \$1.40 per share). As part of the acquisition of the Mirror Worlds Patent Portfolio, professional fees and filing fees of \$409,000 were capitalized as patent cost.

[3] Lease Agreements:

The Company leases its principal office space in New York City at a monthly base rent of approximately \$3,700 which lease expires on May 31, 2017.

The Company entered into a lease agreement in July 2011 to rent office space in New Canaan, Connecticut. In August 2015, the Company entered into an agreement to extend the lease for a four year period (expiring September 30, 2019) at a base rent of \$7,000 per month for the first year (increasing \$100 per month each year), which is subject to annual adjustments to reflect increases in real estate taxes and operating expenses.

Mirror Worlds Technologies, LLC, the Company's wholly-owned subsidiary, entered into a one year lease, at a base rent of \$620 per month, to rent office space in Tyler, Texas (expiring April 30, 2018).

NOTE I - EMPLOYMENT ARRANGEMENTS AND OTHER AGREEMENTS

[1] On July 14, 2016, the Company entered into a new employment agreement ("Agreement") with its Chairman and Chief Executive Officer pursuant to which he continues to serve the Company in such positions for a five year term, at an annual base salary of \$475,000 which shall be increased by 3% per annum during the term of the Agreement. The Agreement established an annual target bonus of \$175,000 for the Chairman and Chief Executive Officer based upon performance. In addition, the Company granted to the Chairman and Chief Executive Officer, under its 2013 Stock Incentive Plan, 750,000 restricted stock units (the "RSUs") which vest in three tranches, as follows: (i) 250,000 RSUs shall vest on July 14, 2018, subject to the Chairman and Chief Executive Officer's continued employment by the Company through the vesting date (the "Employment Condition"); (ii) 250,000 RSUs shall vest at any time beginning July 14, 2018

## NOTE I - EMPLOYMENT ARRANGEMENTS AND OTHER AGREEMENTS (continued)

through July 14, 2021 in equal annual installments for the remaining term of employment, subject to (1) the Employment Condition being satisfied through each such annual vesting date and (2) the Company's common stock achieving a closing price (for 20 consecutive trading days) of a minimum of \$3.25 per share (subject to adjustment for stock splits) at any time during the term of employment; and (iii) 250,000 RSUs vest at any time beginning July 14, 2018 through July 14, 2021 in equal annual installments for the remaining term of employment subject to (1) the Employment Condition being satisfied through each such annual vesting date and (2) the Company's common stock achieving a closing price (for 20 consecutive trading days) of a minimum of \$4.25 per share (subject to adjustment for stock splits) at any time during the term of employment. The aforementioned stock price vesting conditions of \$3.25 per share and \$4.25 per share have been satisfied. Notwithstanding the above, in the event of a Change of Control (as defined), a Termination Other Than for Cause (as defined), or a termination of employment by the Chairman and Chief Executive Officer for Good Reason (as defined), all of the 750,000 RSUs shall accelerate and become immediately fully vested.

Under the terms of the Agreement, so long as the Chairman and Chief Executive Officer continues to serve as an executive officer of the Company, whether pursuant to the Agreement or otherwise, the Chairman and Chief Executive Officer shall also receive incentive compensation in an amount equal to 5% of the Company's gross royalties or other payments from Licensing Activities (as defined) (without deduction of legal fees or any other expenses) with respect to its Remote Power Patent and a 10% net interest (gross royalties and other payments after deduction of all legal fees and litigation expenses related to licensing, enforcement and sale activities, but in no event shall he receive less than 6.25% of the gross recovery) of the Company's royalties and other payments relating to Licensing Activities with respect to patents other than the Remote Power Patent (including the Mirror Worlds Patent Portfolio and the Cox Patent Portfolio) (collectively, the "Incentive Compensation"). During the three months ended March 31, 2017 and March 31, 2016, the Chairman and Chief Executive Officer earned Incentive Compensation of \$311,000 and \$259,000, respectively. As of March 31, 2017 and December 31, 2016, \$258,000 and \$748,000 of such compensation were included in accrued expenses, respectively. The Incentive Compensation shall continue to be paid to the Chairman and Chief Executive Officer for the life of each of the Company's patents with respect to licenses entered into with third parties during the term of his employment or at anytime thereafter, whether he is employed by the Company or not; provided, that, the Chairman and Chief Executive Officer's employment has not been terminated by the Company "For Cause" (as defined) or terminated by him without "Good Reason" (as defined). In the event of a merger or sale of substantially all of the assets of the Company, the Company has the option to extinguish the right of the Chairman and Chief Executive Officer to receive future Incentive Compensation by payment to him of a lump sum payment, in an amount equal to the fair market value of such future interest as determined by an independent third party expert if the parties do not reach agreement as to such value. In the event that the Chairman and Chief Executive Officer's employment is terminated by the Company "Other Than For Cause" (as defined) or by him for "Good Reason" (as defined), the Chairman and Chief Executive Officer shall also be entitled to (i) a lump sum severance payment of 12 months base salary, (ii) a pro-rated portion of the \$175,000 target bonus provided bonus criteria have been satisfied on a pro-rated basis through the calendar quarter in which the termination occurs and (iii) accelerated vesting of all unvested options, warrants, RSUs and other awards.

NOTE I - EMPLOYMENT ARRANGEMENTS AND OTHER AGREEMENTS (continued)

In connection with the Agreement, the Chairman and Chief Executive Officer has also agreed not to compete with the Company as follows: (i) during the term of the Agreement and for a period of 12 months thereafter if his employment is terminated "Other Than For Cause" (as defined) provided he is paid his 12 month base salary severance amount and (ii) for a period of two years from the termination date, if terminated "For Cause" by the Company or "Without Good Reason" by the Chairman and Chief Executive Officer.

[2] The Company's Chief Financial Officer serves on an at-will basis, pursuant to an offer letter dated April 9, 2014, at an annual base salary of \$175,000 (increased in June 2016 from \$157,500) and is eligible to receive incentive or bonus compensation on an annual basis in the discretion of the Company's Compensation Committee. In connection with the offer letter, the Chief Financial Officer was issued, under the Company's 2013 Stock Incentive Plan, a 5-year stock option to purchase 50,000 shares of the common stock, at an exercise price of \$1.65 per share, which option vested in two equal amounts (25,000 shares each) on each of December 31, 2014 and December 31, 2015. In addition, in the event the Chief Financial Officer's employment is terminated without "Good Cause" (as defined), he shall receive (i) (a) 6 months base salary or (b) 12 months base salary in the event of a termination without "Good Cause" within 6 months following a "Change of Control" of the Company (as defined) and (ii) accelerated vesting of all remaining unvested shares underlying his options or any other awards he may receive in the future.

[3] The Company's Executive Vice President serves on an at-will basis at an annual base salary of \$200,000 and is eligible to receive incentive or bonus compensation on an annual basis in the discretion of the Company's Compensation Committee.

NOTE J - LEGAL PROCEEDINGS

[1] In September 2011, the Company initiated patent litigation against sixteen (16) data networking equipment manufacturers (and affiliated entities) in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of its Remote Power Patent. Named as defendants in the lawsuit, excluding related parties, were Alcatel-Lucent USA, Inc., Allied Telesis, Inc., Avaya Inc., AXIS Communications Inc., Dell, Inc., GarrettCom, Inc., Hewlett-Packard Company, Huawei Technologies USA, Juniper Networks, Inx., Motorola Solutions, Inc., NEC Corporation, Polycom Inc., Samsung Electronics Co., Ltd., ShoreTel, Inc., Sony Electronics, Inc., and Transitions Networks, Inc. The Company seeks monetary damages based upon reasonable royalties. To date, the Company has achieved settlement agreements with twelve (12) of the defendants. The remaining four defendants are Hewlett Packard Company, Inc., Juniper Networks, Inc, AXIS Communications Inc. and Avaya Inc. The litigation has been consolidated for pre-trial issues and there will be a separate trial for each defendant. On January 19, 2017, defendant Avaya, Inc. filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. As a result of the bankruptcy filing, the litigation against Avaya is currently subject to an automatic stay. The first of the trials is scheduled to commence on November 6, 2017.

NOTE J - LEGAL PROCEEDINGS (continued)

[2] In July 2010, the Company settled its patent litigation pending in the United States District Court for the Eastern District of Texas, Tyler Division, against Adtran, Inc, Cisco Systems, Inc. and Cisco-Linksys, LLC, (collectively, "Cisco"), Enterasys Networks, Inc., Extreme Networks, Inc., Foundry Networks, Inc., and 3Com Corporation, Inc. As part of the settlement, Adtran, Cisco, Enterasys, Extreme Networks and Foundry Networks each entered into a settlement agreement with the Company and entered into non-exclusive licenses for the Company's Remote Power Patent (the "Licensed Defendants"). Under the terms of the licenses, the Licensed Defendants paid the Company upon settlement approximately \$32 million and also agreed to license the Remote Power Patent for its full term, which expires in March 2020. In accordance with the Settlement and License Agreement, dated May 25, 2011, Cisco is obliged to pay the Company royalties (which began in the first quarter of 2011) based on its sales of PoE products up to maximum royalty payments per year of \$9 million beginning in 2016 (\$8 million through 2015) for the remaining term of the patent. The royalty payments are subject to certain conditions including the continued validity of the Company's Remote Power Patent, and the actual royalty amounts received may be less than the cap stated above. Under the terms of the Agreement, if the Company grants other licenses with lower royalty rates to third parties (as defined in the Agreement), Cisco shall be entitled to the benefit of the lower royalty rates provided it agrees to the material terms of such other license. Under the terms of the Agreement, the Company has certain obligations to Cisco and if it materially breaches such terms, Cisco will be entitled to stop paying royalties to the Company. This would have a material adverse effect on the Company's business, financial condition and results of operations.

[3] On April 4, 2014 and December 3, 2014, the Company initiated litigation against Google Inc. ("Google") and YouTube, LLC ("YouTube") in the United States District Court for the Southern District of New York for infringement of several of its patents within the Cox Patent Portfolio acquired from Dr. Cox (see Note H[2] hereof) which relate to the identification of media content on the Internet. The lawsuits allege that Google and YouTube have infringed and continue to infringe certain of the Company's patents by making, using, selling and offering to sell unlicensed systems and related products and services, which include YouTube's Content ID system.

The above referenced litigations that the Company commenced in the United States District Court for the Southern District of New York in April 2014 and December 2014 against Google and YouTube are currently subject to a court ordered stay which has been in effect since July 2015 as a result of proceedings at the Patent Trial and Appeal Board (PTAB) and the pending appeals to the United States District Court of Appeals for the Federal Circuit.

NOTE K – STOCK REPURCHASE

On August 22, 2011, the Company announced that its Board of Directors approved a share repurchase program to repurchase up to \$2,000,000 of shares of its common stock over the next 12 months ("Share Repurchase Program"). On June 9, 2016, the Board of Directors authorized an extension of the Share Repurchase Program to repurchase up to \$2,654,000 of common stock over the subsequent 12 month period (for a total of up to \$14,000,000 since inception of the program in August 2011). The common stock may be repurchased from time to time in open market transactions or privately negotiated transactions in the Company's discretion. The timing and amount of the shares repurchased is determined by management based on its evaluation of market conditions and other factors. The Share Repurchase Program may be increased, suspended or discontinued at any time.

NOTE K – STOCK REPURCHASE (continued)

Since inception of the Share Repurchase Program through March 31, 2017, the Company has repurchased an aggregate of 6,926,004 shares of its common stock at a cost of \$11,463,873 (exclusive of commissions) or an average per share price of \$1.66. All such repurchased shares have been cancelled. During the three months ended March 31, 2017, the Company did not repurchase any shares of its common stock. At March 31, 2017, the approximate dollar value of shares that may be repurchased under the Share Repurchase Program was \$2,536,000.

NOTE L – CONCENTRATIONS

Revenue from one licensee constituted approximately 77% and 91% of the Company's revenue for the three months ended March 31, 2017 and March 31, 2016, respectively. At March 31, 2017, royalty receivables from two licensees constituted approximately 84% of the Company's net royalty receivables. At December 31, 2016, royalty receivables from three licenses constituted approximately 85% of the Company's net royalty receivables.

NOTE M - DIVIDENDS

On December 7, 2016, the Board of Directors of the Company approved the initiation of a dividend policy providing for the payment of a regular semi-annual dividend of \$0.05 per common share (\$0.10 per common share annually) commencing in 2017. The Company anticipates paying the semi-annual dividends in March and September of each year. It is anticipated that the semi-annual regular dividend will continue to be paid through March 2020 (the expiration of the Company's Remote Power Patent) provided that the Company continues to receive royalties from licensees of its Remote Power Patent.

On February 2, 2017, the Board of Directors of the Company declared an initial semi-annual cash dividend of \$0.05 per common share with a payment date of March 24, 2017 to all common stockholders of record as of March 3, 2017.

During the three months ended March 31, 2017, the Company accrued dividends of \$47,000 for unvested restricted stock units with dividend equivalent rights.

NOTE N – SUBSEQUENT EVENTS

[1] On May 2, 2017, Judge Robert W. Schroeder of the United States District Court for the Eastern District of Texas, Tyler Division, in the Company's patent infringement action currently pending against four defendants with respect to its Remote Power Patent (see Note J[1]), issued an order adopting the prior report and recommendation of the United States Magistrate Judge which found that all of the claims of the Remote Power Patent were not invalid. As a result of the Court's decision, the balance of \$2,300,000 of the Company's settlement with ALE USA Inc. reached in July 2016 is payable to the Company in three equal quarterly payments of \$766,666 beginning July 1, 2017. The settlement balance of \$2,300,000 will be recorded by the Company as revenue in the second quarter of 2017.

[2] On May 9, 2017, the Company's wholly-owned subsidiary, Mirror Worlds Technologies, LLC, initiated patent litigation against Facebook, Inc. in United States District Court for the Southern District of New York for infringement of U.S. Patent No. 6,006,227, U.S. Patent No. 7,865,538 and U.S. Patent No. 8,255,439, patents within the Company's Mirror Worlds Patent Portfolio. The lawsuit alleges that the aforementioned patents are infringed by Facebook's core technologies that enable Facebook's Newsfeed and Timeline features. The lawsuit further alleges that Facebook's unauthorized use of the stream based solutions of the asserted Company patents has helped Facebook become the most popular social networking site in the world.



ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

THIS QUARTERLY REPORT ON FORM 10-Q CONTAINS FORWARD-LOOKING STATEMENTS WHICH ARE STATEMENTS THAT INCLUDE INFORMATION BASED UPON BELIEF OF OUR MANAGEMENT, AS WELL AS ASSUMPTIONS MADE BY AND INFORMATION AVAILABLE TO MANAGEMENT. STATEMENTS CONTAINING TERMS SUCH AS "BELIEVES", "EXPECTS", "ANTICIPATES", "INTENDS" OR SIMILAR WORDS ARE INTENDED TO IDENTIFY FORWARD LOOKING STATEMENTS. ACTUAL RESULTS, EVENTS AND CIRCUMSTANCES (INCLUDING FUTURE PERFORMANCE, RESULTS AND TRENDS) COULD DIFFER MATERIALLY FROM THOSE SET FORTH IN SUCH STATEMENTS DUE TO VARIOUS RISKS AND UNCERTAINTIES, INCLUDING, BUT NOT LIMITED TO, THOSE DISCUSSED ON PAGES 16-26 OF OUR ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2016 FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON MARCH 20, 2017 AND IN THIS QUARTERLY REPORT ON FORM 10-Q.

OVERVIEW

Our principal business is the development, licensing and protection of our intellectual property assets. We presently own thirty-three (33) patents including (i) our Remote Power Patent covering the delivery of power over Ethernet cables for the purpose of remotely powering network devices, such as wireless access ports, IP phones and network based cameras; (ii) our Mirror Worlds Patent Portfolio relating to foundational technologies that enable unified search and indexing, displaying and archiving of documents in a computer system; (iii) our Cox Patent Portfolio relating to enabling technology for identifying media content on the Internet and taking further action to be performed based on such identification; and (iv) our QoS Patents covering systems and methods for the transmission of audio, video and data in order to achieve high quality of service (QoS) over computer and telephony networks. In addition, we continually review opportunities to acquire or license additional intellectual property.

We have been actively engaged in the licensing of our Remote Power Patent (U.S. Patent No. 6,218,930). We currently have twenty-four (24) licensees for our Remote Power Patent which, among others, include license agreements with Cisco Systems, Inc., Extreme Networks, Inc., Netgear, Inc., Microsemi Corporation, Motorola Solutions, Inc., NEC Corporation, Samsung Electronics Co., Ltd., Dell, Inc., Huawei Technologies Co., Ltd., ShoreTel, Inc. and Polycom, Inc. and several other major data networking equipment manufacturers. Our current strategy includes continuing our licensing efforts with respect to our intellectual property assets. In addition, we continue to seek to acquire additional intellectual property assets to develop, commercialize, license or otherwise monetize such intellectual property. Our strategy includes working with inventors and patent owners to assist in the development and monetization of their patented technologies. We may also enter into strategic relationships with third parties to develop, commercialize, license or otherwise monetize their intellectual property.

Our acquisition strategy focuses on acquiring high quality patents which management believes have the potential to generate significant licensing opportunities as we have achieved with respect to our Remote Power Patent and Mirror Worlds Patent Portfolio. Our Remote Power Patent generated licensing revenue in excess of \$111,000,000 from May 2007 through March 31, 2017. As a result of our acquisition of the Mirror Worlds Patent Portfolio in May 2013, we achieved licensing and other revenue from the portfolio of an aggregate of \$47,150,000 through March 31, 2017.



At March 31, 2017, our principal sources of liquidity consisted of cash and cash equivalents of \$48,000,000 and working capital of \$53,820,000. We believe based on our current cash position and projected licensing revenue from existing licensees that we will have sufficient cash to fund our operations for the foreseeable future. Based on our cash position, we continually review opportunities to acquire additional intellectual property as well as evaluate other strategic alternatives.

On December 9, 2016, we announced that our Board of Directors approved the initiation of a dividend policy. The policy provides for the payment of regular semi-annual dividends of \$0.05 per common share (\$0.10 per common share annually) which are anticipated to be paid in March and September of each year. It is anticipated that the semi-annual dividend will continue to be paid through March 2020 (expiration of our Remote Power Patent) provided that we continue to receive royalties from licensees of our Remote Power Patent. On February 2, 2017, our Board of Directors declared an initial semi-annual dividend \$0.05 per common share with a payment date of March 24, 2017 to all shareholders of record on March 3, 2017.

Our revenue from our patent licensing and enforcement business is generated from license agreements entered into as a result of litigation settlements or judgments (after a jury verdict). Generally, in the event of settlement of litigation related to our assertion of patent infringement involving our intellectual property, defendants will either pay (i) a lump sum payment for a non-exclusive fully-paid license (a "Fully-Paid License"), or (ii) a lump sum payment (license initiation fee) together with an ongoing obligation to pay quarterly or monthly royalties to us for the life of the licensed patent (a "Royalty Bearing License").

#### Royalty Bearing Licenses

We currently have Royalty Bearing Licenses for our Remote Power Patent with sixteen (16) licensees pursuant to which such licensees are obligated to pay us ongoing royalties on a quarterly or monthly basis for the life of our Remote Power Patent (March 2020). Revenue from ongoing royalties from our Royalty Bearing Licenses was \$6,221,000 for the three months ended March 31, 2017 as compared to \$5,190,000 for the three months ended March 31, 2016. We had Royalty Bearing Licenses with sixteen (16) licensees for the three months ended March 31, 2017 as compared to thirteen (13) licensees for the three months ended March 31, 2016. Cisco is our largest royalty bearing licensee. Cisco constituted 77% and 91% of our ongoing royalty revenue from our Royalty Bearing Licenses for the three months ended March 31, 2017 and March 31, 2016, respectively. Due to our annual royalty rate structure with Cisco, which includes declining rates as the volume of PoE products sales increase during the year, royalties from Cisco are typically highest in the first quarter of the calendar year and decline for each of the remaining calendar quarters of the year.

The obligation of our licensees to continue to make ongoing royalty payments to us from Royalty Bearing Licenses is contingent upon the continued validity of certain claims of our Remote Power Patent. The validity of our Remote Power Patent is currently at issue in our pending litigation against four data equipment manufacturers in the United States District Court for the Eastern District of Texas (see "Legal Proceedings" at pages 29-31 hereof). If certain claims of our Remote Power Patent are ultimately determined to be invalid, such a determination would have a material adverse effect on our business, financial condition and results of operations as our revenue stream is largely dependent upon the continued validity of our Remote Power Patent.

## Pending Litigation

We currently have pending patent infringement litigations involving our Remote Power Patent and certain patents within our Cox Patent Portfolio and Mirror Worlds Patent Portfolio (see "Legal Proceedings" at pages 29 – 32 hereof).

In September 2011, we initiated patent litigation against sixteen (16) data equipment manufacturers in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of our Remote Power Patent. We have since settled the litigation against twelve (12) of the defendants. The remaining four defendants in the litigation are Hewlett Packard Company, Inc., Juniper Networks, Inc., Avaya Inc. and AXIS Communications, Inc. The first of the trials for the defendants is scheduled to commence on November 6, 2017 (see "Legal Proceedings" at pages 29-31 hereof).

In April 2014 and December 2014, we initiated patent infringement litigation against Google Inc. and YouTube, LLC in the United States District Court for the Southern District of New York for infringement of several patents within our Cox Patent Portfolio (see "Legal Proceedings" at page 32 hereof). These litigations are currently subject to a court ordered stay pending appeal to the United States Court of Appeals for the Federal Circuit of Final Written Decisions of the Patent Trial and Appeal Board (PTAB) of the USPTO in our favor relating to four Inter Partes Review proceedings and a Covered Business Method Review (CBM) instituted by Google (see "Legal Proceedings" at page 32 of this quarterly report).

In May 2017, we initiated patent infringement litigation against Facebook, Inc. ("Facebook") in the United States District Court for the Southern District of New York, for infringement of our U.S. Patent No. 6,006,227 (the "'227 Patent"), U.S. Patent No. 7,865,538 and U.S. Patent No. 8,225,439 (among the patents we acquired as part of our acquisition of our Mirror Worlds Patent Portfolio) (see "Legal Proceedings" at page 31 hereof).

## Taxes

We utilized our remaining net operating loss carry-forwards (NOLs) during the year ended December 31, 2016. Current federal, state and local income taxes of \$955,000 were recorded for the three months ended March 31, 2017. The remaining deferred tax assets of \$168,000 at March 31, 2017 relate to temporary (timing) differences with respect to outstanding options, warrants and restricted stock units.

The personal holding company ("PHC") rules under the Internal Revenue Code impose a 20% tax on a PHC's undistributed personal holding company income ("PHC Income", which means, in general, taxable income subject to certain adjustments). For a corporation to be classified as a PHC, it must satisfy two tests: (i) that more than 50% in value of its outstanding shares must be owned directly or indirectly by 5 or fewer individuals at anytime during the second half of the year (after applying constructive ownership rules to attribute stock owned by entities to their beneficial owners and among certain family members and other related parties) (the "Ownership Test") and (ii) at least 60% of its adjusted ordinary gross income for a taxable year consists of dividends, interest, royalties, annuities and rents (the "Income Test"). During the second half of 2016 (as well as prior years), we did not meet the Ownership Test. Due to the significant number of shares held by our largest shareholders, we will continually assess our share ownership to determine whether it meets the Ownership Test. If the Ownership Test were met and the income generated by us were determined to constitute "royalties" within the meaning of the Income Test, we would constitute a PHC and we would be subject to a 20% tax on the amount of any PHC Income that we do not distribute to our shareholders.



## RESULTS OF OPERATIONS

### Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

**Revenue.** We had revenue of \$6,221,000 for the three months ended March 31, 2017 as compared to revenue of \$5,190,000 for the three months ended March 31, 2016. The increase in revenue of \$1,031,000 or 20% for the three months ended March 31, 2017 was the result of increased revenue from Royalty Bearing Licenses for our Remote Power Patent.

**Operating Expenses.** Operating expenses for the three months ended March 31, 2017 were \$2,968,000 as compared to \$2,767,000 for the three months ended March 31, 2016. The increase in operating expenses of \$201,000 was primarily due to an increase in costs of revenue of \$306,000 associated with our increase in revenue and an increase in stock based compensation of \$225,000, offset by decreased amortization of patents of \$364,000. We had costs of revenue of \$1,792,000 and \$1,486,000 for the three months ended March 31, 2017 and March 31, 2016, respectively. Included in the costs of revenue for three months ended March 31, 2017 were contingent legal fees and expenses of \$1,481,000 and \$311,000 of incentive bonus compensation payable to our Chairman and Chief Executive Officer pursuant to his employment agreement (see Note H and Note I[1] to our unaudited condensed consolidated financial statements included in this quarterly report). Included in the costs of revenue for the three months ended March 31, 2016 were contingent legal fees and expenses of \$1,227,000 payable to our patent litigation counsel and \$259,000 of incentive bonus compensation payable to our Chairman and Chief Executive Officer pursuant to his employment agreement.

General and administrative expenses increased by \$81,000 from \$403,000 for the three months ended March 31, 2016 to \$484,000 for the three months ended March 31, 2017. Amortization of patents was \$50,000 for the three months ended March 31, 2017 as compared to \$414,000 for the three months ended March 31, 2016. Stock-based compensation expense related to the issuance of restricted stock units was \$237,000 for the three months ended March 31, 2017 as compared to \$12,000 for the vesting of stock options for the three months ended March 31, 2016. Professional fees and related costs were \$405,000 for the three months ended March 31, 2017 as compared to \$452,000 for the three months ended March 31, 2016.

**Interest Income.** Interest income for the three months ended March 31, 2017 was \$9,000 as compared to interest income of \$10,000 for the three months ended March 31, 2016.

**Operating Income.** We had operating income of \$3,253,000 for the three months ended March 31, 2017 compared with an operating income of \$2,423,000 for the three months ended March 31, 2016. The increased operating income of \$830,000 for the three months ended March 31, 2017 was primarily due to increased revenue of \$1,031,000 from Royalty Bearing Licenses for our Remote Power Patent.

**Current Taxes.** Federal, state and local income taxes of \$955,000 and \$51,000 were recorded for the three months ended March 31, 2017 and March 31, 2016, respectively. The increase in such taxes of \$904,000 was due to our utilization of net operating loss carry-forwards with respect to net income of \$3,820,000 for the three months ended March 31, 2016.

**Deferred Tax Expense (benefit).** We recorded deferred tax expense (benefit) of \$39,000 and \$(1,438,000) for the three months ended March 31, 2017 and March 31, 2016, respectively. The deferred tax expense of \$39,000 for the three months ended March 31, 2017 relates to temporary (timing) differences with respect to outstanding options, warrants and restricted stock units. The deferred tax (benefit) of \$(1,438,000) was due to relief of our valuation allowance of \$2,280,000 based upon future utilization of net operating loss carry-forwards with respect to future income, offset by taxes (approximately \$842,000) on net income of \$3,820,000 for the three months ended March 31, 2016.

Net Income. As a result of the foregoing, we realized net income of \$2,268,000 or \$0.09 per share (basic and diluted) for the three months ended March 31, 2017 compared with net income of \$3,820,000 or \$0.16 per share (basic and diluted) for the three months ended March 31, 2016.

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## LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations primarily from revenue from licensing our patents. At March 31, 2017, our principal sources of liquidity consisted of cash and cash equivalents of \$48,000,000 and working capital of \$53,820,000. We believe based on our current cash position and projected licensing revenue from our existing license agreements that we will have sufficient cash to fund our operations for the foreseeable future.

At March 31, 2017, we had royalty receivables of \$7,020,000 consisting of \$6,020,000 due from Royalty Bearing Licenses, which are typically paid within sixty days of the end of the quarter, and a \$1,000,000 settlement payment due in October 2017.

Working capital increased by \$2,405,000 to \$53,820,000 at March 31, 2017 as compared to working capital of \$51,415,000 at December 31, 2016. The increase in working capital for the three months ended March 31, 2017 was primarily due to an increase in royalty receivables of \$4,141,000, decreases in accrued contingency fees and related costs of \$771,000 and accrued payroll of \$1,490,000, offset by a decrease in cash and cash equivalents of \$2,918,000 and prepaid taxes of \$955,000.

Net cash (used) provided by operating activities for the three months ended March 31, 2017 changed by \$2,895,000 from \$118,000 for the three months ended March 31, 2016 to \$(2,777,000) for the three months ended March 31, 2017. The change in net cash used by operating activities for the three months ended March 31, 2017 was primarily due to changes in accrued expenses of \$3,062,000 and royalty receivables of \$476,000.

Net cash used in investing activities for the three months ended March 31, 2017 and March 31, 2016 was \$0 and \$2,000, respectively, related to the purchase of patents.

Net cash provided by (used in) financing activities for the three months ended March 31, 2017 and March 31, 2016 was \$(141,000) and \$15,000, respectively. The change primarily resulted from the exercise of stock options and warrants of \$1,068,000 and \$60,000 during the three months ended March 31, 2017 and 2016, respectively, which was offset by the payment of a cash dividend of \$1,209,000 for the three months ended March 31, 2017.

We maintain our cash primarily in money market accounts. Accordingly, we do not believe that our investments have significant exposure to interest rate risk.

## OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements.

## CONTRACTUAL OBLIGATIONS

We do not have any long-term debt, capital lease obligations, operating lease obligations, purchase obligations or other long-term liabilities except for the lease obligations set forth in Note H[3] to our financial statements included in this quarterly report.

## CRITICAL ACCOUNTING POLICIES

Our condensed consolidated financial statements are prepared in accordance with GAAP. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses, and related disclosures. These estimates form the basis for judgments we make about the carrying values of our assets and liabilities, which are not readily apparent from other sources. We base our estimates and judgments on historical experience and on various other assumptions that we believe are reasonable under the circumstances. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions. We believe that the assumptions and estimates associated with revenue recognition, patents, income taxes, impairment of long lived assets and stock-based compensation have the greatest potential impact on our condensed consolidated financial statements. Therefore, we consider these to be our critical accounting policies and estimates. There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. See also Note B to our unaudited condensed consolidated financial statements included in this report.

## Effect of New Accounting Pronouncements

In August 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, which amends ASC 230, Statement of Cash Flows. This ASU provides guidance on the statement of cash flows presentation of certain transactions where diversity in practice exists. The guidance is effective for interim and annual periods beginning after December 15, 2017, and early adoption is permitted. We do not believe that the adoption of this ASU will have a material impact on our unaudited condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). ASU No. 2016-02 is effective for annual periods beginning after December 15, 2018, and requires a lessee to recognize assets and liabilities for leases with a maximum possible term of more than 12 months. A lessee would recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the leased asset (the underlying asset) for the lease term. Early application is permitted. We do not believe that adoption of this accounting standard will have a material impact on our unaudited condensed consolidated financial statements.

In May 2014, FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 provides for a single comprehensive model for use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance. The new revenue standard allows for either full retrospective or modified retrospective application. We are required to adopt the amendments in ASU No. 2014-09 using one of the two acceptable methods. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which deferred the effective date of ASU No. 2014-09 to annual periods beginning after December 2017, along with an option to permit early adoption as of the original effective date. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which amends the guidance in 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property. The ASU does not change the core principle of the guidance in Topic 606. In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, related to disclosures of remaining performance obligations, as well as other amendments to guidance on collectability, non-cash consideration and the presentation of sales and other similar taxes collected from customers. The effective date and transition requirements for the ASUs are the same as the effective date and transition requirements in Topic 606. Public entities should apply the ASUs for annual reporting periods beginning after December 15, 2017, including interim reporting periods therein (i.e., January 1, 2018, for a calendar year entity). Early application for public entities is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. We expect to complete our assessment process, including identifying our

performance obligations and selecting a transition method for adoption, by the end of the second quarter of 2017 along with our implementation process prior to the adoption of this ASU on January 1, 2018.

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Accounting Standards Adopted in the Period

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends Accounting Standards Codification ("ASC") Topic 718, Compensation - Stock Compensation. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Prior to this amendment, excess tax benefits resulting from the difference between the deduction for tax purposes and the compensation costs recognized for financial reporting were not recognized until the deduction reduced taxes payable. Under the new method we will recognize excess tax benefits in the current accounting period. Additionally, ASU 2016-09 requires that we present excess tax benefits on the Statement of Cash Flows as an operating activity. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016. We adopted ASU 2016-09 in the first quarter of 2017 and elected to apply this adoption prospectively. Prior periods have not been adjusted. The effective tax rate for the three months ended March 31, 2017 differed from the Federal statutory rate primarily due to the recognition of excess tax benefits as a component of the provision for income taxes attributable to the adoption of ASU 2016-09.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable

ITEM 4. CONTROLS AND PROCEDURES.

(a) Evaluation of Disclosure Controls and Procedures.

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based upon this review, these officers concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in applicable rules and forms and is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls

There was no change in our internal control over financial reporting that occurred during the fiscal quarter ended March 31, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1: LEGAL PROCEEDINGS

Remote Power Patent Legal Proceedings

In September 2011, we initiated patent litigation against sixteen (16) data networking equipment manufacturers (and affiliated entities) in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of our Remote Power Patent. Named as defendants in the lawsuit (excluding affiliated parties) were Alcatel-Lucent USA, Inc., Allied Telesis, Inc., Avaya Inc., AXIS Communications Inc., Dell, Inc., GarretCom, Inc., Hewlett-Packard Company, Huawei Technologies USA, Juniper Networks, Inc., Motorola Solutions, Inc., NEC Corporation, Polycom Inc., Samsung Electronics Co., Ltd., ShoreTel, Inc., Sony Electronics, Inc., and Transition Networks, Inc. We seek monetary damages based upon reasonable royalties.

In March 2012, we reached settlement agreements with defendants Motorola Solutions, Inc. ("Motorola") and Transition Networks, Inc. ("Transition Networks"). In October 2012, we reached a settlement with defendant GarretCom, Inc ("GarretCom"). In February 2013, we reached settlement agreements with Allied Telesis, Inc. ("Allied Telesis") and NEC Corporation ("NEC"). As part of the settlements, Motorola, Transition Networks, GarretCom, Allied Telesis and NEC each entered into a non-exclusive license agreement for our Remote Power Patent pursuant to which each such defendant agreed to license our Remote Power Patent for its full term (which expires in March 2020) and pay a license initiation fee and ongoing royalties based on their sales of PoE products. In March 2015 and July 2015, we reached settlements with defendants Samsung Electronics Co., Ltd. ("Samsung"), Huawei Technologies Co., Ltd. ("Huawei") and ShoreTel, Inc. ("ShoreTel"). Samsung and Huawei each entered into a non-exclusive fully paid license agreement for our Remote Power Patent for its full term. ShoreTel entered into a non-exclusive license agreement for our Remote Power Patent for its full term and paid a license initiation fee and

agreed to pay quarterly royalties based upon its sales of PoE products.

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In June 2016, we reached a settlement with Sony Corporation and affiliated entities ("Sony"). With respect to the settlement, Sony received a non-exclusive fully-paid license for our Remote Power Patent for its remaining life.

In July 2016, we reached a settlement with Dell, Inc. Under the terms of the settlement, Dell received a non-exclusive license for our Remote Power Patent for its full term, Dell paid a license initiation fee of \$6,000,000 and agreed to pay quarterly royalties based on its sales of PoE products.

In July 2016, we also reached settlement agreements with Alcatel-Lucent USA, Inc. and Alcatel-Lucent Holdings Inc. (collectively, "Alcatel") and ALE, USA, Inc. ("ALE"). Under the terms of the settlement agreements, Alcatel and ALE received a non-exclusive fully paid license for our Remote Power Patent for its remaining life. The aggregate consideration to be received by us from Alcatel and ALE for the fully-paid license is \$4,200,000 of which \$1,900,000 has been paid and the balance of \$2,300,000 is payable in three equal quarterly payments beginning sixty (60) days after a ruling by the Court (which was rendered on May 2, 2017) adopting the report and recommendation rendered by the United States Magistrate Judge which found all of the asserted claims of our Remote Power Patent were not invalid.

On October 3, 2016, we entered a settlement agreement with Polycom, Inc. ("Polycom"). Under the terms of the settlement, Polycom entered into a non-exclusive license for our Remote Power Patent for its full term and is obligated to pay a license initiation fee of \$5,000,000 for past sales of its Power over Ethernet ("PoE") products and ongoing royalties based on its sales of PoE products. \$2,000,000 of the license initiation fee was paid within 30 days and the balance will be paid in three annual installments of \$1,000,000 beginning in October 2017. Payments due in October 2018 and October 2019 need not be paid by Polycom if all asserted claims of our Remote Power Patent have been found invalid. Such payments in October 2018 and October 2019 have not been included in our revenue to date.

As a result of the aforementioned settlements, the remaining four defendants in the litigation pending in the United States District Court for the Eastern District of Texas are Hewlett Packard Company, Inc., Juniper Networks, Inc., AXIS Communications Inc. and Avaya Inc. The litigation is consolidated for pre-trial purposes and there will be a separate trial for each defendant. On June 2, 2016, a Markman hearing on claim construction was held and oral argument also took place on defendants' motion for summary judgment that all asserted claims of our Remote Power Patent are invalid under 35 U.S.C. §325 for improper broadening. On November 2, 2016, the Court issued its ruling on the Markman hearing and defendants' motion for summary judgment (the motion asserted that all claims of the Remote Power Patent were invalid for improper claim broadening). The Court found that all of the original asserted claims of the Remote Power Patent survived the challenge and only one claim (Claim 23 obtained during a Reexamination of the Remote Power Patent at the USPTO in 2014) was invalid due to improper claim broadening. On January 19, 2017, defendant Avaya Inc. filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York. As a result of the filing, our litigation against Avaya Inc. is currently subject to an automatic stay. The litigation will continue against the three other remaining defendants. On March 7, 2017, we made a motion for relief from the automatic stay in the United States District Court for the Southern District of New York which is pending. The first of the trials for the defendants is scheduled to commence on November 6, 2017.

## Mirror Worlds Patent Portfolio Litigation

### Pending Facebook Litigation

On May 9, 2017, Mirror Worlds Technologies, LLC, our wholly-owned subsidiary, initiated litigation against Facebook, Inc. ("Facebook") in the United States District Court for the Southern District of New York, for infringement of U.S. Patent No. 6,006,227, U. S. Patent No. 7,865,538 and U.S. Patent No. 8,255,439 (among the patents within our Mirror Worlds Patent Portfolio). The lawsuit alleges that the asserted patents are infringed by Facebook's core technologies that enable Facebook's Newsfeed and Timeline features. The lawsuit further alleges that Facebook's unauthorized use of the stream based solutions of our asserted patents has helped Facebook become the most popular social networking site in the world with more than 1.94 billion monthly active users as of March 2017. We seek, among other things, monetary damages based upon reasonable royalties.

### Prior Litigation

On May 23, 2013, we initiated patent litigation in the United States District Court for the Eastern District of Texas, Tyler Division, against Apple Inc., Microsoft Corporation, Hewlett-Packard Company, Lenovo Group Ltd., Lenovo (United States), Inc., Dell, Inc., Best Buy Co., Inc., Samsung Electronics America, Inc. and Samsung Telecommunications America L.L.C., for infringement of U.S. Patent No. 6,006,227 (the "'227 Patent"). We sought, among other things, monetary damages based upon reasonable royalties. The lawsuit alleged that the defendants have infringed and continue to infringe the claims of the '227 Patent by making, selling, offering to sell and using infringing products including Mac OS and Windows operating systems and personal computers and tablets that include versions of those operating systems, and by encouraging others to make, sell, and use these products. On December 10, 2013, the litigation was severed into two consolidated actions, Mirror Worlds v. Apple, Inc. (Case No. 6:13-cv-419), and Mirror Worlds v. Microsoft, et al. (Case No. 6:13-cv-941).

On November 6, 2015, we entered into a settlement agreement with Microsoft pursuant to which Microsoft (including its customers) received a non-exclusive fully paid license for our Mirror Worlds Patent Portfolio for its remaining life in consideration of a lump sum payment to us of \$4,650,000. In addition, as customers of Microsoft, the pending litigation was also dismissed against Hewlett-Packard Corporation, Lenovo Group Ltd., Lenovo, Inc., Dell, Inc., Best Buy Co., Inc., Samsung Electronics of America, Inc. and Samsung Telecommunications America L.L.C.

On July 8, 2016, we entered into a settlement agreement with Apple Inc. in connection with litigation in the United States District Court for the Eastern District of Texas, for infringement of our '227 Patent. Under the terms of the settlement agreement, Apple received a fully paid non-exclusive license to the '227 Patent for its full term (which expired in June 2016), along with certain rights to other patents in our patent portfolio. We received \$25,000,000 from Apple for the settlement and fully paid non-exclusive license.

Cox Patent Portfolio – Google and YouTube Legal Proceedings

On April 4, 2014, we initiated litigation against Google Inc. ("Google") and YouTube, LLC ("YouTube") in the United States District Court for the Southern District of New York for infringement of several of our patents within our Cox Patent Portfolio which relate to the identification of media content on the Internet. The lawsuit alleges that Google and YouTube have infringed and continue to infringe certain of our patents by making, using, selling and offering to sell unlicensed systems and related products and services, which include YouTube's Content ID system. In May 2014, the defendants filed an answer to our complaint and asserted defenses of non-infringement and invalidity.

On December 3, 2014, we initiated a second litigation against Google and YouTube in the United States District Court for the Southern District of New York for infringement of our then newly issued patent (part of the Cox Patent Portfolio) relating to the identification and tagging of media content (U.S. Patent No. 8,904,464). The lawsuit alleges that Google and YouTube have infringed and continue to infringe the patent by making, using, selling and offering to sell unlicensed systems and products and services related thereto, which include YouTube's content ID system. In January 2015, the defendants filed an answer to our complaint and asserted defenses of non-infringement and invalidity.

The above referenced litigations that we commenced in the United States District Court for the Southern District of New York in April 2014 and December 2014 against Google and YouTube are currently subject to a court ordered stay which has been in effect since July 2015 as a result of proceedings at the Patent Trial and Appeal Board (PTAB) and the pending appeals of PTAB Final Written Decisions to the United States District Court of Appeals for the Federal Circuit as described below.

In December 2014, Google filed four petitions to institute Inter Partes Review proceedings (the "IPRs") at the PTAB pertaining to certain patents within our Cox Patent Portfolio. In each of the IPRs, Google sought to invalidate certain claims of our patents within our Cox Patent Portfolio which have been asserted in our litigations against Google and YouTube pending in the United States District Court for the Southern District of New York as described above. On June 23, 2015, the PTAB issued an order instituting each of the four IPR petitions for oral hearing. The consolidated oral hearing was held on March 9, 2016. On June 20, 2016, the PTAB issued its Final Written Decisions in the four pending IPRs finding eighty-six (86) claims "not unpatentable" (valid) and in total, one hundred nineteen (119) out of one hundred and twenty-nine (129) or 92% of the challenged claims of the patents survived. None of our asserted claims in the pending litigations against Google and YouTube were found invalid. On August 18, 2016, Google filed Notices of Appeal to appeal the PTAB's Final Written Decisions on the IPRs to the United States Court of Appeals for the Federal Circuit and the appeal is pending.

On April 13, 2015, Google filed a Petition for Covered Business Method Review (CBM) at the PTAB seeking to invalidate claims pertaining to our U.S. Patent No. 8,904,464, the patent asserted in our litigation against Google and YouTube filed on December 3, 2014 as referenced above. On October 19, 2015, the PTAB issued an order instituting the Covered Business Method Review for oral hearing. The oral hearing was held on May 11, 2016. On October 18, 2016, the PTAB issued its Final Written Decision in favor of us with respect to the CBM and ruled that Google had failed to show that any of the thirty-four (34) claims of our U.S. Patent 8,904,464 were unpatentable. On December 20, 2016, Google filed a Notice of Appeal to appeal the PTAB's Final Written Decision on the CBM to the United States Court of Appeals for the Federal Circuit and the appeal is pending.

ITEM 1A. Risk Factors.

Our operations and financial results are subject to various risks and uncertainties that could adversely affect our business, financial condition, results of operations and trading price of our common stock. In addition to the risks described in this quarterly report, our Annual Report on Form 10-K for the year ended December 31, 2016 (pages 16-26) filed with the Securities and Exchange Commission on March 20, 2017 includes a discussion of our risk factors and should be carefully considered by investors.

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

Recent Issuances of Unregistered Securities

There were no such issuances during the three months ended March 31, 2017.

Stock Repurchases

On August 22, 2011, we announced that our Board of Directors approved a share repurchase program to repurchase up to \$2,000,000 of shares of our common stock over the next 12 months ("Share Repurchase Program"). On June 9, 2016, our Board of Directors authorized its fifth extension of the Share Repurchase Program to repurchase up to \$2,654,000 of shares of our common stock over the subsequent 12 month period. The common stock may be repurchased from time to time in open market transactions or privately negotiated transactions in our discretion. The timing and amount of the shares repurchased is determined by management based on its evaluation of market conditions and other factors. The Share Repurchase Program may be increased, suspended or discontinued at any time. Since inception of the Share Repurchase Program in August 2011 through March 31, 2017, we have repurchased an aggregate of 6,926,004 shares of our common stock at an aggregate cost of \$11,463,873 (exclusive of commissions) or an average per share price of \$1.66. During the three months ended March 31, 2017, we did not purchase any shares of our common stock. At March 31, 2017, the approximate dollar value of shares that may be repurchased under the Share Repurchase Program was \$2,536,000.

ITEM 3. Defaults Upon Senior Securities.

None.

ITEM 5. Other Information.

None.

ITEM 6. Exhibits

(a) Exhibits

31.1 Controls and Procedure Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*

31.2 Controls and Procedure Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.\*

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

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.\*

101 Interactive data files:\*\*

101.INS XBRL Instance Document

101.SCH XBRL Scheme Document

101.CAL XBRL Calculation Linkbase Document

101.DEF XBRL Definition Linkbase Document

101.LAB XBRL Label Linkbase Document

101.PRE XBRL Presentation Linkbase Document

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\* Filed herewith

\*\* Furnished 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.

NETWORK-1 TECHNOLOGIES, INC.

Date: May 15, 2017 By: /s/ Corey M. Horowitz  
Corey M. Horowitz  
Chairman and Chief Executive Officer

Date: May 15, 2017 By: /s/ David C. Kahn  
David C. Kahn  
Chief Financial Officer