

Digimarc CORP
Form 10-Q
October 24, 2014
Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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: 001-34108

DIGIMARC CORPORATION
(Exact name of registrant as specified in its charter)

Oregon
(State or other jurisdiction of
incorporation or organization)
9405 SW Gemini Drive, Beaverton, Oregon 97008
(Address of principal executive offices) (Zip Code)
(503) 469-4800
(Registrant's telephone number, including area code)

26-2828185
(I.R.S. Employer
Identification No.)

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 20, 2014, there were 7,693,663 shares of the registrant's common stock, par value \$0.001 per share, outstanding.

Table of Contents

Table of Contents

PART I FINANCIAL INFORMATION

| | | |
|---------|---|----|
| Item 1. | <u>Financial Statements (Unaudited):</u> | 3 |
| | <u>Consolidated Balance Sheets as of September 30, 2014 and December 31, 2013</u> | 3 |
| | <u>Consolidated Statements of Operations for the three- and nine-months ended September 30, 2014 and 2013</u> | 4 |
| | <u>Consolidated Statements of Shareholders' Equity for the nine-months ended September 30, 2014 and 2013</u> | 5 |
| | <u>Consolidated Statements of Cash Flows for the nine-months ended September 30, 2014 and 2013</u> | 6 |
| | <u>Notes to Consolidated Financial Statements</u> | 7 |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 17 |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 29 |
| Item 4. | <u>Controls and Procedures</u> | 29 |

PART II OTHER INFORMATION

| | | |
|----------|--|----|
| Item 1. | <u>Legal Proceedings</u> | 31 |
| Item 1A. | <u>Risk Factors</u> | 31 |
| Item 2. | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 41 |
| Item 6. | <u>Exhibits</u> | 42 |
| | <u>SIGNATURES</u> | 43 |

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****DIGIMARC CORPORATION****CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share data)****(UNAUDITED)**

| | September 30, 2014 | December 31, 2013 |
|---|-------------------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,704 | \$ 3,811 |
| Marketable securities | 19,081 | 25,851 |
| Trade accounts receivable, net | 3,851 | 5,838 |
| Other current assets | 3,541 | 1,658 |
| Total current assets | 29,177 | 37,158 |
| Marketable securities | 2,951 | 5,302 |
| Property and equipment, net | 2,904 | 2,395 |
| Intangibles, net | 6,836 | 6,709 |
| Goodwill | 1,114 | 1,114 |
| Deferred tax assets, net | 5,447 | 3,949 |
| Other assets | 410 | 570 |
| Total assets | \$ 48,839 | \$ 57,197 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable and other accrued liabilities | \$ 1,868 | \$ 1,560 |
| Deferred revenue | 1,853 | 4,218 |
| Total current liabilities | 3,721 | 5,778 |
| Deferred rent and other long-term liabilities | 241 | 496 |
| Total liabilities | 3,962 | 6,274 |
| Commitments and contingencies (Note 14) | | |
| Shareholders' equity: | | |
| Preferred stock (par value \$0.001 per share, 2,500,000 authorized, 10,000 shares issued and outstanding at September 30, 2014 and December 31, 2013) | 50 | 50 |
| | 8 | 7 |

Edgar Filing: Digimarc CORP - Form 10-Q

| | | |
|--|-----------|-----------|
| Common stock (par value \$0.001 per share, 50,000,000 authorized, 7,689,471 and 7,401,072 shares issued and outstanding at September 30, 2014 and December 31, 2013, respectively) | | |
| Additional paid-in capital | 43,756 | 41,498 |
| Retained earnings | 1,063 | 9,368 |
| Total shareholders' equity | 44,877 | 50,923 |
| Total liabilities and shareholders' equity | \$ 48,839 | \$ 57,197 |

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

Table of Contents

DIGIMARC CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(UNAUDITED)

| | Three Months Ended September 30, 2014 | Three Months Ended September 30, 2013 | Nine Months Ended September 30, 2014 | Nine Months Ended September 30, 2013 |
|--|---|---|--|--|
| Revenue: | | | | |
| Service | \$ 3,155 | \$ 3,030 | \$ 8,859 | \$ 8,981 |
| Subscription | 1,452 | 1,424 | 4,360 | 4,241 |
| License | 2,320 | 2,971 | 6,576 | 14,916 |
| Total revenue | 6,927 | 7,425 | 19,795 | 28,138 |
| Cost of revenue: | | | | |
| Service | 1,224 | 1,232 | 3,807 | 4,067 |
| Subscription | 812 | 625 | 2,160 | 1,848 |
| License | 84 | 98 | 250 | 294 |
| Total cost of revenue | 2,120 | 1,955 | 6,217 | 6,209 |
| Gross profit | 4,807 | 5,470 | 13,578 | 21,929 |
| Operating expenses: | | | | |
| Sales and marketing | 1,999 | 1,482 | 5,930 | 4,322 |
| Research, development and engineering | 3,499 | 3,277 | 10,449 | 8,824 |
| General and administrative | 2,183 | 2,456 | 6,929 | 6,990 |
| Intellectual property | 366 | 278 | 1,287 | 816 |
| Total operating expenses | 8,047 | 7,493 | 24,595 | 20,952 |
| Operating income (loss) | (3,240) | (2,023) | (11,017) | 977 |
| Other income, net | 3 | 33 | 50 | 81 |
| Income (loss) before income taxes | (3,237) | (1,990) | (10,967) | 1,058 |
| (Provision) benefit for income taxes | 1,252 | 1,195 | 4,316 | (280) |
| Net income (loss) | \$ (1,985) | \$ (795) | \$ (6,651) | \$ 778 |
| Earnings (loss) per common share: | | | | |
| Earnings (loss) per common share basic | \$ (0.28) | \$ (0.12) | \$ (0.95) | \$ 0.09 |
| Earnings (loss) per common share diluted | \$ (0.28) | \$ (0.12) | \$ (0.95) | \$ 0.09 |
| | 7,176 | 6,860 | 7,097 | 6,850 |

Weighted average common shares
outstanding basic

| | | | | |
|---|-------|-------|-------|-------|
| Weighted average common shares outstanding diluted | 7,176 | 6,860 | 7,097 | 7,080 |
|---|-------|-------|-------|-------|

| | | | | |
|--|----|---------|---------|---------|
| Cash dividends declared per common share | \$ | \$ 0.11 | \$ 0.22 | \$ 0.33 |
|--|----|---------|---------|---------|

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

Table of Contents

DIGIMARC CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(In thousands, except share data)

(UNAUDITED)

| | Preferred Stock | | Common Stock | | Additional Paid-in Capital | Retained Earnings | Total Shareholders Equity |
|--|-----------------|--------|--------------|--------|----------------------------------|----------------------|---------------------------------|
| | Shares | Amount | Shares | Amount | | | |
| BALANCE AT DECEMBER 31, 2012 | 10,000 | \$ 50 | 7,168,359 | \$ 7 | \$ 39,869 | \$ 13,077 | \$ 53,003 |
| Exercise of stock options | | | 18,300 | | | | |
| Issuance of restricted common stock | | | 217,090 | | | | |
| Forfeiture of restricted common stock | | | (67,360) | | | | |
| Purchase and retirement of common stock | | | (47,101) | | (854) | | (854) |
| Stock-based compensation | | | | | 3,305 | | 3,305 |
| Net income | | | | | | 778 | 778 |
| Cash dividends declared | | | | | | (2,400) | (2,400) |
| BALANCE AT SEPTEMBER 30, 2013 | 10,000 | \$ 50 | 7,289,288 | \$ 7 | \$ 42,320 | \$ 11,455 | \$ 53,832 |
| BALANCE AT DECEMBER 31, 2013 | 10,000 | \$ 50 | 7,401,072 | \$ 7 | \$ 41,498 | \$ 9,368 | \$ 50,923 |
| Exercise of stock options | | | 184,784 | 1 | 1,318 | | 1,319 |
| Issuance of restricted common stock | | | 204,720 | | | | |
| Forfeiture of restricted common stock | | | (12,995) | | | | |
| Purchase and retirement of common stock | | | (88,110) | | (1,931) | | (1,931) |
| Stock-based compensation | | | | | 4,218 | | 4,218 |
| Tax impact of stock-based awards | | | | | (1,347) | | (1,347) |
| Net loss | | | | | | (6,651) | (6,651) |
| Cash dividends declared | | | | | | (1,654) | (1,654) |
| BALANCE AT SEPTEMBER 30, 2014 | 10,000 | \$ 50 | 7,689,471 | \$ 8 | \$ 43,756 | \$ 1,063 | \$ 44,877 |

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

Table of Contents

DIGIMARC CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(UNAUDITED)

| | Nine Months Ended September 30, 2014 | Nine Months Ended September 30, 2013 |
|--|---|---|
| Cash flows from operating activities: | | |
| Net income (loss) | \$ (6,651) | \$ 778 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization of property and equipment | 708 | 513 |
| Amortization and write-off of intangibles | 916 | 931 |
| Change in allowance for doubtful accounts | (13) | 22 |
| Gain on reversal of contingent merger consideration | | (190) |
| Stock-based compensation | 4,085 | 3,219 |
| Deferred income taxes | (2,874) | 354 |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable, net | 2,000 | (923) |
| Other current assets | (1,559) | (577) |
| Other assets | 160 | (99) |
| Accounts payable and other accrued liabilities | (171) | 286 |
| Income taxes payable | (169) | 88 |
| Deferred revenue | (2,338) | 263 |
| Net cash provided by (used in) operating activities | (5,906) | 4,665 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (1,010) | (1,532) |
| Capitalized patent costs | (922) | (824) |
| Maturity of marketable securities | 47,961 | 47,344 |
| Purchase of marketable securities | | |