Digimarc CORP
Form 10-Q
April 28, 2015
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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended March 31, 2015**

**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** | **26-2828185** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**9405 SW Gemini Drive, Beaverton, Oregon 97008**

**(Address of principal executive offices) (Zip Code)**

**(503) 469-4800**

**(Registrant s telephone number, including area code)**

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 x |
| 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 x

As of April 22, 2015, there were 8,544,154 shares of the registrant s common stock, par value $0.001 per share, outstanding.

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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements.**

### DIGIMARC CORPORATION

### CONSOLIDATED BALANCE SHEETS

**(In thousands, except per share data)**

**(UNAUDITED)**

| | March 31, 2015 | December 31, 2014 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 5,064 | $ 6,122 |
| Marketable securities | 32,031 | 32,201 |
| Trade accounts receivable, net | 3,620 | 4,545 |
| Other current assets | 2,518 | 2,611 |
| Total current assets | 43,233 | 45,479 |
| Marketable securities | | 749 |
| Property and equipment, net | 2,895 | 2,976 |
| Intangibles, net | 6,692 | 6,720 |
| Goodwill | 1,114 | 1,114 |
| Other assets | 337 | 378 |
| Total assets | $ 54,271 | $ 57,416 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable and other accrued liabilities | $ 1,473 | $ 1,379 |
| Deferred revenue | 2,984 | 3,660 |
| Total current liabilities | 4,457 | 5,039 |
| Deferred rent and other long-term liabilities | 158 | 203 |
| Total liabilities | 4,615 | 5,242 |
| Commitments and contingencies (Note 12) | | |
| Shareholders equity: | | |
| Preferred stock (par value $0.001 per share, 2,500 authorized, 10 shares issued and outstanding at March 31, 2015 and December 31, 2014) | 50 | 50 |
| Common stock (par value $0.001 per share, 50,000 authorized, 8,540 and 8,427 shares issued and outstanding at March 31, 2015 and December 31, 2014, | 9 | 8 |

| | | |
|---|---|---|
| respectively) | | |
| Additional paid-in capital | 61,853 | 60,222 |
| Accumulated deficit | (12,256) | (8,106) |
| Total shareholders equity | 49,656 | 52,174 |
| Total liabilities and shareholders equity | $ 54,271 | $ 57,416 |

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

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**DIGIMARC CORPORATION**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share data)**

**(UNAUDITED)**

| | Three Months Ended March 31, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| Revenue: | | |
| Service | $ 3,501 | $ 2,988 |
| Subscription | 1,716 | 1,412 |
| License | 772 | 2,805 |
| Total revenue | 5,989 | 7,205 |
| Cost of revenue: | | |
| Service | 1,578 | 1,414 |
| Subscription | 754 | 649 |
| License | 84 | 83 |
| Total cost of revenue | 2,416 | 2,146 |
| Gross profit | 3,573 | 5,059 |
| Operating expenses: | | |
| Sales and marketing | 2,090 | 1,879 |
| Research, development and engineering | 3,084 | 3,546 |
| General and administrative | 2,206 | 2,421 |
| Intellectual property | 367 | 534 |
| Total operating expenses | 7,747 | 8,380 |
| Operating loss | (4,174) | (3,321) |
| Other income, net | 23 | 27 |
| Loss before income taxes | (4,151) | (3,294) |
| Benefit for income taxes | 1 | 1,308 |
| Net loss | $ (4,150) | $ (1,986) |
| Earnings (loss) per common share: | | |
| Loss per common share basic | $ (0.52) | $ (0.29) |
| Loss per common share diluted | $ (0.52) | $ (0.29) |
| Weighted average common shares outstanding basic | 7,960 | 7,000 |

| | | |
|---|---|---|
| Weighted average common shares outstanding diluted | 7,960 | 7,000 |
| Cash dividends declared per common share | $ | $ 0.11 |

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

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**DIGIMARC CORPORATION**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

**(In thousands)**

**(UNAUDITED)**

| | Preferred Stock Shares | Preferred Stock Amount | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings (Accumulated Deficit) | Total Shareholders Equity |
|---|---|---|---|---|---|---|---|
| **BALANCE AT DECEMBER 31, 2013** | 10 | $ 50 | 7,401 | $ 7 | $ 41,498 | $ 9,368 | $ 50,923 |
| Exercise of stock options | | | 122 | 1 | 711 | | 712 |
| Issuance of restricted common stock | | | 57 | | | | |
| Forfeiture of restricted common stock | | | (7) | | | | |
| Purchase and retirement of common stock | | | (51) | | (850) | | (850) |
| Stock-based compensation | | | | | 1,304 | | 1,304 |
| Tax impact from stock-based awards | | | | | 72 | | 72 |
| Net loss | | | | | | (1,986) | (1,986) |
| Cash dividends declared | | | | | | (824) | (824) |
| **BALANCE AT MARCH 31, 2014** | 10 | $ 50 | 7,522 | $ 8 | $ 42,735 | $ 6,558 | $ 49,351 |
| **BALANCE AT DECEMBER 31, 2014** | 10 | $ 50 | 8,427 | $ 8 | $ 60,222 | $ (8,106) | $ 52,174 |
| Exercise of stock options | | | 45 | 1 | 873 | | 874 |
| Issuance of restricted common stock | | | 90 | | | | |
| Forfeiture of restricted common stock | | | (5) | | | | |
| Purchase and retirement of common stock | | | (17) | | (496) | | (496) |
| Stock-based compensation | | | | | 1,254 | | 1,254 |
| Net loss | | | | | | (4,150) | (4,150) |
| **BALANCE AT MARCH 31, 2015** | 10 | $ 50 | 8,540 | $ 9 | $ 61,853 | $ (12,256) | $ 49,656 |

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

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**DIGIMARC CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

**(UNAUDITED)**

| | Three Months Ended March 31, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (4,150) | $ (1,986) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation, amortization and write-off of property and equipment | 328 | 231 |
| Amortization and write-off of intangibles | 277 | 308 |
| Changes in allowance for doubtful accounts | 10 | (7) |
| Stock-based compensation | 1,217 | 1,259 |
| Deferred income taxes | | (509) |
| Excess tax benefit from stock-based awards | | (72) |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | 915 | 1,809 |
| Other current assets | 93 | (699) |
| Other assets | 41 | 84 |
| Accounts payable and other accrued liabilities | (99) | (314) |
| Deferred revenue | (668) | (1,484) |
| Net cash used in operating activities | (2,036) | (1,380) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (125) | (117) |
| Capitalized patent costs | (194) | (295) |
| Maturity of marketable securities | 21,976 | 11,192 |
| Purchase of marketable securities | (21,057) | (9,266) |
| Net cash provided by investing activities | 600 | 1,514 |
| Cash flows from financing activities: | | |
| Exercise of stock options | 874 | 712 |
| Purchase of common stock | (496) | (850) |
| Cash dividends paid | | (824) |
| Excess tax benefit from stock-based awards | | 72 |
| Net cash provided by (used in) financing activities | 378 | (890) |
| Net decrease in cash and cash equivalents | (1,058) | (756) |

| | | | | |
|---|---|---|---|---|
| Cash and cash equivalents at beginning of period | | 6,122 | | 3,811 |
| Cash and cash equivalents at end of period | $ | 5,064 | $ | 3,055 |
| Supplemental disclosure of cash flow information: | | | | |
| Cash paid (received) for income taxes, net | $ | 2 | $ | (12) |
| Supplemental schedule of non-cash investing activities: | | | | |
| Stock-based compensation capitalized to patent costs and software | $ | 37 | $ | 45 |

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

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**DIGIMARC CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(In thousands, except per share data)**

**(UNAUDITED)**

## 1. Description of Business and Significant Accounting Policies

*Description of Business*

Digimarc Corporation ( Digimarc or the Company ), an Oregon corporation, enables governments and enterprises around the world to give digital identities to media and objects that computers can sense and recognize and to which they can react. The Company has developed an intuitive computing platform that is intended to optimize the identification of consumer brand impressions, facilitating modern mobile-centric shopping. The platform includes means to infuse persistent digital information, Digimarc IDs, perceptible only to computers and digital devices, into all forms of media content, including consumer products packaging. Digimarc IDs for packaging, often referred to as Digimarc Barcodes, facilitate remarkably faster scanning of items at retail checkout as well as improved interaction with consumers. The unique digital identifier placed in media generally persists with it regardless of the distribution path and whether it is copied, manipulated or converted to a different format, and does not affect the quality of the content or the enjoyment or other traditional uses of it. The Company s technology permits computers and digital devices to quickly and reliably identify relevant data from vast amounts of media content.

*Interim Consolidated Financial Statements*

The Company has adhered to the accounting policies set forth in its Annual Report on Form 10-K for the year ended December 31, 2014 in preparing the accompanying interim consolidated financial statements.

The accompanying interim consolidated financial statements have been prepared from the Company s records without audit and, in management s opinion, include all adjustments (consisting of only normal recurring adjustments) necessary to fairly reflect the financial condition and the results of operations for the periods presented. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (the U.S. GAAP ) have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission ( SEC ).

These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2014, which was filed with the SEC on February 20, 2015. The results of operations for the interim periods presented in these consolidated financial statements are not necessarily indicative of the results for the full year.

*Reclassifications*

Certain prior period amounts in the accompanying consolidated financial statements and notes thereto have been reclassified to conform to current period presentation. These reclassifications had no material effect on the results of operations or financial position for any period presented.

***Recent Accounting Pronouncements***

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2014-09, *Revenue from Contracts with Customers (Topic 606).* ASU No 2014-09 provides specific guidance to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The amendments in this update are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The amendments in this update permit the use of either the retrospective or cumulative effect transition method. The Company has not yet selected a transition method and is currently assessing the potential future impact of this standard on the financial condition or results of operations of the Company.

On April 1, 2015, the FASB tentatively agreed to propose a one-year deferral of the effect date for ASU 2014-09, but would permit all entities to adopt the standard as of the original effective date for public business entities (i.e., annual periods beginning after December 15, 2016, and interim periods therein). The FASB expects to issue an Exposure Draft for this issue in the near term.

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## 2. Fair Value of Financial Instruments

The estimated fair values of the Company s financial instruments, which include cash equivalents, accounts receivable, accounts payable and other accrued liabilities approximate their carrying values due to the short-term nature of these instruments. The Company records marketable securities at amortized cost, which approximates fair value.

The Company s fair value hierarchy for its cash equivalents and marketable securities as of March 31, 2015 and December 31, 2014, respectively, was as follows:

| March 31, 2015 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Money market securities | $ 3,367 | $ | $ | $ 3,367 |
| Corporate notes | | 19,995 | | 19,995 |
| Pre-refunded municipal bonds (1) | | 9,067 | | 9,067 |
| Commercial paper | | 1,947 | | 1,947 |
| Certificates of deposits | | 1,442 | | 1,442 |
| Total | $ 3,367 | $ 32,451 | $ | $ 35,818 |

| December 31, 2014 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Money market securities | $ 3,556 | $ | $ | $ 3,556 |
| Corporate notes | | 19,245 | | 19,245 |
| Pre-refunded municipal bonds (1) | | 13,317 | | 13,317 |
| Certificates of deposits | | 2,176 | | 2,176 |
| Total | $ 3,556 | $ 34,738 | $ | $ 38,294 |

(1) Pre-refunded municipal bonds are collateralized by U.S. treasuries.

The fair value maturities of the Company s cash equivalents and marketable securities as of March 31, 2015 are as follows:

| | | Maturities by Period | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1-5 years | 5-10 years | More than 10 years |
| Cash equivalents and marketable securities | $ 35,818 | $ 35,818 | $ | $ | $ |

The Company considers all highly liquid marketable securities with original maturities of 90 days or less at the date of acquisition to be cash equivalents. Cash equivalents include money market funds and certificates of deposit totaling $3,787 and $5,344 at March 31, 2015 and December 31, 2014, respectively. Cash equivalents are carried at cost or amortized cost, which approximates fair value.

## 3. Revenue Recognition

The Company derives its revenue primarily from development services, subscriptions and licensing of its intellectual property:

Service revenue consists primarily of software development and consulting services. The majority of service revenue arrangements are structured as time and materials consulting agreements.

Subscription revenue includes Digimarc Discover, Barcode and Guardian products and services, is generally recurring, paid in advance and recognized over the term of the subscription.

License revenue originates primarily from licensing the Company s intellectual property where the Company receives license fees and/or royalties as its income stream.

Revenue is recognized in accordance with ASC 605 *Revenue Recognition* and ASC 985 *Software* when the following four criteria are met:

(i) persuasive evidence of an arrangement exists,

(ii) delivery has occurred,

(iii) the fee is fixed or determinable, and

(iv) collection is reasonably assured.

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Some customer arrangements encompass multiple deliverables, such as patent licenses, professional services, software licenses, and maintenance and support fees. For arrangements that include multiple deliverables, the Company identifies separate units of accounting at inception based on the consensus reached under ASC 605-25 *Multiple-Element Arrangements*, which provides that revenue arrangements with multiple deliverables should be divided into separate units of accounting if certain criteria are met. The Company applies ASC 985 to software deliverables when relevant. The consideration for the arrangement under ASC 605-25 is allocated to the separate units of accounting using the relative selling price method.

The relative selling price method allocates the consideration based on the Company s specific assumptions rather than assumptions of a marketplace participant, and any discount in the arrangement proportionally to each deliverable on the basis of each deliverable s selling price.

Applicable revenue recognition criteria is considered separately for each separate unit of accounting as follows:

Service revenue is generally determined based on time and materials. Revenue for professional services is recognized as the services are performed. Billing for services rendered generally occurs within one month after the services are provided.

Subscription revenue, which includes Digimarc Discover, Barcode and Guardian products and services, is generally paid in advance and recognized over the term of the subscription, which is generally one to three years.

License revenue is recognized when amounts owed to the Company have been earned, are fixed or determinable (within the Company s normal 30 to 60 day payment terms), and collection is reasonably assured. If the payment terms extend beyond the normal 30 to 60 days, the fee may not be considered to be fixed or determinable, and the revenue would then be recognized when installments are due.

The Company records revenue from certain license agreements upon cash receipt as a result of collectability not being reasonably assured.

The Company s standard payment terms for license arrangements are 30 to 60 days. Extended payment terms on patent license arrangements are not considered to be fixed or determinable if payments are due beyond the Company s standard payment terms, primarily because of the risk of substantial modification present in the Company s patent licensing business. As such, revenue on license arrangements with extended payment terms are recognized as fees become fixed or determinable.

Deferred revenue consists of billings in advance for service, subscription and license contracts for which revenue has not been earned.

**4. Segment Information**

*Geographic Information*

The Company derives its revenue from a single reporting segment: media management solutions. Revenue is generated in this segment through development services, subscriptions and licensing of intellectual property. The Company markets its products in the U.S. and in non-U.S. countries through its sales and licensing personnel.

Revenue by geographic area, based upon the bill-to location, was as follows:

| | **Three Months Ended March 31, 2015** | **Three Months Ended March 31, 2014** |
|---|---|---|
| Domestic | $ 1,687 | $ 3,117 |
| International (1) | 4,302 | 4,088 |
| Total | $ 5,989 | $ 7,205 |

(1) Revenue from the Central Banks, consisting of a consortium of central banks around the world, is classified as international revenue. Reporting revenue by country for this customer is not practicable.

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*Major Customers*

Customers who accounted for 10% or more of the Company s revenue are as follows:

| | Three Months Ended March 31, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| Central Banks | 59% | 43% |
| The Nielsen Company ( Nielsen ) | | 16% |
| Verance Corporation ( Verance ) | | 10% |

In the first quarter of 2014, Nielsen made its final quarterly license fee payment under its patent license agreement.

In the third quarter of 2014, the Company extended the patent license agreement with Verance through 2023, in effect waiving any future royalties and license fees, in exchange for a $1.0 million license fee payment.

**5. Stock-Based Compensation**

Stock-based compensation includes expense charges for all stock-based awards to employees and directors. These awards include stock option grants and restricted stock awards.

Stock-based compensation expense related to internal labor is capitalized to patent costs and software based on direct labor hours charged to capitalized patent costs and software.

***Determining Fair Value***

*Stock Options*

*Valuation and Amortization Method.* The Company estimates the fair value of stock options granted using the Black-Scholes option valuation model. The Company amortizes the fair value of all awards on a straight-line basis over the requisite service periods, which are generally the vesting periods.

*Expected Life.* The expected life of awards granted represents the period of time that they are expected to be outstanding. The Company determines the expected life based on historical experience with similar awards, giving consideration to the contractual terms, vesting schedules and pre-vesting and post-vesting forfeitures. Stock options granted generally vest over three to four years for employee grants and one to two years for director grants, and have contractual terms of ten years.

*Expected Volatility.* The Company estimates the volatility of its common stock at the date of grant based on the historical volatility of its common stock based on historical prices over the most recent period commensurate with the expected life of the award.

*Risk-Free Interest Rate.* The Company determines the risk-free interest rate using current U.S. treasury yields for bonds with a maturity commensurate with the expected life of the award.

*Expected Dividend Yield.* The expected dividend yield is derived by the Company s expected annual dividend rate over the expected term divided by the fair value of the Company s common stock at the grant date.

There were no stock options granted during the three-month periods ended March 31, 2015 and 2014.

The Company records stock-based compensation expense for stock option awards only for those awards that are expected to vest.

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*Restricted Stock*

The fair value of restricted stock awarded is based on the fair market value of the Company s common stock on the date of the grant (measurement date), and is recognized over the vesting period using the straight-line method.

The Company records stock-based compensation expense for restricted stock awards only for those awards that are expected to vest.

***Stock-based Compensation***

| | Three Months Ended March 31, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| Stock-based compensation: | | |
| Cost of revenue | $ 185 | $ 142 |
| Sales and marketing | 159 | 142 |
| Research, development and engineering | 287 | 356 |
| General and administrative | 518 | 550 |
| Intellectual property | 68 | 69 |
| Stock-based compensation expense | 1,217 | 1,259 |
| Capitalized to patent costs and software | 37 | 45 |
| Total stock-based compensation | $ 1,254 | $ 1,304 |

The following table sets forth total unrecognized compensation cost related to non-vested stock-based awards granted under all equity compensation plans, including stock options and restricted stock:

| | As of March 31, 2015 | As of December 31, 2014 |
|---|---|---|
| Total unrecognized compensation costs | $ 12,411 | $ 11,206 |

Total unrecognized compensation costs will be adjusted for any future changes in estimated forfeitures.

The Company expects to recognize the unrecognized compensation costs as of March 31, 2015 for stock options and restricted stock over weighted average periods through March 2019 as follows:

| | Stock Options | Restricted Stock |
|---|---|---|
| Weighted average period | 0.0 years | 1.6 years |

*Stock Option Activity*

As of March 31, 2015, under all of the Company s stock-based compensation plans, equity awards to purchase an additional 1,411 shares were authorized for future grants under the plans. The Company issues new shares upon option exercises. The following table reconciles the outstanding balance of stock options:

| **Three-months ended March 31, 2015:** | **Options** | **Weighted Average Exercise Price** | **Weighted Average Grant Date Fair Value** | **Aggregate Intrinsic Value** |
|---|---|---|---|---|
| Outstanding at December 31, 2014 | 601 | $ 16.97 | $ 8.42 | |
| Options granted | | | | |
| Options exercised | (45) | 19.45 | 8.66 | |
| Options canceled or expired | | | | |
| Outstanding at March 31, 2015 | 556 | $ 16.76 | $ 8.40 | $ 4,055 |
| Exercisable at March 31, 2015 | 556 | $ 16.76 | | $ 4,055 |

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The aggregate intrinsic value is based on the closing price of $21.95 per share of Digimarc common stock on March 31, 2015, which would have been received by the optionees had all of the options with exercise prices less than $21.95 per share been exercised on that date.

*Restricted Stock Activity*

The following table reconciles the unvested balance of restricted stock:

| Three-months ended March 31, 2015: | Number of Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| Unvested balance, December 31, 2014 | 502 | $ 23.09 |
| Granted | 90 | $ 28.66 |
| Vested | (42) | $ 23.14 |
| Canceled | (5) | $ 27.01 |
| Unvested balance, March 31, 2015 | 545 | $ 23.97 |

The fair value of all restricted stock awards that vested during the three-months ended March 31, 2015 and 2014 was $1,213 and $1,367, respectively.

**6. Earnings (Loss) Per Common Share**

The Company calculates basic and diluted earnings per common share in accordance with ASC 260 *Earnings Per Share*, using the two-class method because the Company s unvested restricted stock is a participating security since these awards contain non-forfeitable rights to receive dividends. Under the two-class method, earnings are allocated to each class of common stock and participating security as if all of the net earnings for the period had been distributed.

Basic earnings per common share excludes dilution and is calculated by dividing earnings to common shares by the weighted-average number of common shares outstanding for the period. Diluted earnings per common share is calculated by dividing earnings to common shares by the weighted-average number of common shares, as adjusted for the potentially dilutive effect of stock options. The following table reconciles earnings (loss) per common share for the three-months ended March 31, 2015 and 2014:

| | Three Months Ended March 31, 2015 | Three Months Ended March 31, 2014 |
|---|---|---|
| **Basic Earnings (Loss) per Common Share:** | | |
| ***Numerator:*** | | |
| Net loss | $ (4,150) | $ (1,986) |
| Distributed earnings to common shares | | 773 |

| | | | | |
|---|---|---|---|---|
| Distributed earnings to participating securities | | | | 51 |
| Total distributed earnings | | | | 824 |
| Undistributed loss allocable to common shares | | (4,150) | | (2,810) |
| Undistributed earnings allocable to participating securities | | | | |
| Total undistributed loss | | (4,150) | | (2,810) |
| Loss to common shares basic | $ | (4,150) | $ | (2,037) |
| ***Denominator*** | | | | |
| Weighted average common shares outstanding basic | | 7,960 | | 7,000 |
| Basic earnings (loss) per common share | $ | (0.52) | $ | (0.29) |

| | | Three Months Ended March 31, 2015 | | Three Months Ended March 31, 2014 |
|---|---|---|---|---|
| **Diluted Earnings (Loss) per Common Share:** | | | | |
| ***Numerator:*** | | | | |
| Loss to common shares basic | $ | (4,150) | $ | (2,037) |
| Undistributed earnings allocated to participating securities | | | | |
| Undistributed earnings reallocated to participating securities | | | | |
| Loss to common shares diluted | $ | (4,150) | $ | (2,037) |
| ***Denominator***: | | | | |
| Weighted average common shares outstanding basic | | 7,960 | | 7,000 |
| Dilutive effect of stock options | | | | |
| Weighted average common shares outstanding dilutive | | 7,960 | | 7,000 |
| Diluted earnings (loss) per common share | $ | (0.52) | $ | (0.29) |

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There were 212 and 220 common stock equivalents related to stock options that were anti-dilutive and excluded from diluted earnings per common share for the three-months ended March 31, 2015 and 2014, respectively, as the Company incurred a net loss for the period.

## 7. Trade Accounts Receivable

*Trade Accounts Receivable*

Trade accounts receivable are recorded at the invoiced amount.

| | March 31, 2015 | December 31, 2014 |
|---|---|---|
| Trade accounts receivable | $ 3,652 | $ 4,567 |
| Allowance for doubtful accounts | (32) | (22) |
| Trade accounts receivable, net | $ 3,620 | $ 4,545 |
| Unpaid deferred revenue included in trade accounts receivable | $ 542 | $ 1,974 |

*Allowance for doubtful accounts*

The allowance for doubtful accounts is the Company s best estimate of the amount of probable credit losses in the Company s existing trade accounts receivable. The Company determines the allowance based on historical write-off experience and current information. The Company reviews its allowance for doubtful accounts each reporting period. Account balances are charged against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

*Unpaid deferred revenue*

The unpaid deferred revenue that is included in trade accounts receivable is billed in accordance with the provisions of the contracts with the Company s customers. Unpaid deferred revenue from the Company s cash-basis customers is not included in trade accounts receivable nor deferred revenue.

*Major customers*

Customers who accounted for 10% or more of trade accounts receivable, net are as follows:

| | March 31, 2015 | December 31, 2014 |
|---|---|---|
| Central Banks | 61% | 61% |
| Civolution | * | 13% |

* Less than 10%

**8. Property and Equipment**

Property and equipment are stated at cost. Repairs and maintenance are charged to expense when incurred.

Depreciation on property and equipment is calculated using the straight-line method over the estimated useful lives of the assets, generally two to seven years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful life or the lease term.

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| | March 31, 2015 | December 31, 2014 |
|---|---|---|
| Office furniture fixtures | $ 848 | $ 845 |
| Software | 1,392 | 1,312 |
| Equipment | 3,089 | 3,072 |
| Leasehold improvements | 1,229 | 1,198 |
| Gross property and equipment | 6,558 | 6,427 |
| Less accumulated depreciation and amortization | (3,663) | (3,451) |
| Property and equipment, net | $ 2,895 | $ 2,976 |

**9. Intangibles**

Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Amortization of capitalized patent costs associated with the application and award of patents in the U.S. and various other countries are capitalized and amortized on a straight-line basis over the term of the patents as determined at the award date, which varies depending on the pendency period of the application, generally approximating seventeen years.

Amortization of intangible assets acquired is calculated using the straight-line method over the estimated useful lives of the assets.

| | March 31, 2015 | December 31, 2014 |
|---|---|---|
| Capitalized patent costs | $ 6,334 | $ 6,183 |
| Intangible assets acquired: | | |
| Purchased patents and intellectual property | 250 | 250 |
| Existing technology | 1,560 | 1,560 |
| Customer relationships | 290 | 290 |
| Backlog | 760 | 760 |
| Tradenames | 290 | 290 |
| Non-solicitation agreements | 120 | 120 |
| Gross intangible assets | 9,604 | 9,453 |
| Accumulated amortization | (2,912) | (2,733) |
| Intangibles, net | $ 6,692 | $ 6,720 |

**10. Joint Ventures and Related Party Transactions**

In March 2012, Digimarc and Nielsen decided to reduce the investments in their two joint ventures, TVaura LLC (in which Digimarc holds a 51% ownership interest) and TVaura Mobile LLC (in which Digimarc holds a 49% ownership interest), to minimal levels while assessing alternative approaches to achieving each of their goals in the emerging market opportunity of synchronized second screen television. Payment of all expenses incurred after the suspension of operations of each joint venture is unconditionally the responsibility of the majority owner, which expenses for TVaura LLC, if any, will be paid by Digimarc. As of March 31, 2015, both Digimarc and Nielsen continued to assess the market opportunities of each of the joint ventures.

Summarized financial information for the joint ventures has not been provided as the disclosures are immaterial to the Company s filing given the operations of the joint ventures have been suspended. The joint ventures had no revenue or expenses for the three months ended March 31, 2015 and 2014. The Company s investment in each joint venture was $0 as of March 31, 2015 and December 31, 2014.

**11. Income Taxes**

The benefit for income taxes for the three-months ended March 31, 2015 and 2014 reflects current taxes, deferred taxes, and withholding taxes in certain foreign jurisdictions. The effective tax rate for the three-months ended March 31, 2015 and 2014 was 0% and 40%, respectively. The valuation allowance against net deferred tax assets as of March 31, 2015 was $8,858, an increase of $1,570 from $7,288 as of December 31, 2014.

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**12. Commitments and Contingencies**

Certain of the Company s product license and services agreements include an indemnification provision for claims from third parties relating to the Company s intellectual property. Such indemnification provisions are accounted for in accordance with ASC 450 *Contingencies.* To date, there have been no claims made under such indemnification provisions.

The Company is subject from time to time to other legal proceedings and claims arising in the ordinary course of business.

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

*The following Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements relating to future events or the future financial performance of Digimarc, which involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements. Please see the discussion regarding forward-looking statements included in this Quarterly Report on Form 10-Q under the caption Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995.*

*The following discussion should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Quarterly Report on Form 10-Q. Readers are also urged to carefully review and consider the disclosures made in Part II, Item 1A (Risk Factors) of this Quarterly Report on Form 10-Q and in the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2014 filed on February 20, 2015 (our 2014 Annual Report ), and other reports and filings made with the Securities and Exchange Commission ( SEC ).*

*Unless the context otherwise requires, references in this Quarterly Report on Form 10-Q to Digimarc, we, our and us refer to Digimarc Corporation.*

*All dollar amounts are in thousands except per share amounts or unless otherwise noted. Percentages within the following tables may not foot due to rounding.*

*Digimarc Discover, Digimarc Barcode and Digimarc Guardian are registered trademarks of Digimarc Corporation. This Quarterly Report on Form 10-Q also includes trademarks and trade names owned by other parties, and all other such trademarks and trade names mentioned in this Quarterly Report on Form 10-Q are the property of their respective owners.*

### Overview

Digimarc Corporation enables governments and enterprises around the world to give digital identities to media and objects that computers can sense and recognize and to which they can react. We have developed an intuitive computing platform that is intended to optimize the identification of consumer brand impressions, facilitating modern mobile-centric shopping. The platform includes means to infuse persistent digital information, Digimarc IDs, perceptible only to computers and digital devices, into all forms of media content, including consumer products packaging. Digimarc IDs for packaging, often referred to as Digimarc Barcodes, facilitate remarkably faster scanning of items at retail checkout as well as improved interaction with consumers. The unique digital identifier placed in media generally persists with it regardless of the distribution path and whether it is copied, manipulated or converted to a different format, and does not affect the quality of the content or the enjoyment or other traditional uses of it. Our technology permits computers and digital devices to quickly and reliably identify relevant data from vast amounts of media content.

Our technologies, and those of our licensees, span numerous applications across a wide range of media content, enabling our customers and those of our partners to:

- Improve the speed of retail checkout;
- Provide simple and intuitive mobile customer engagement experiences in stores;

- Quickly and reliably identify and effectively manage music, movies, television programming, digital images, e-books, documents and other printed materials, especially in light of non-linear distribution over the Internet;

- Deter counterfeiting of money, media and goods, and piracy of e-books, movies and music;

- Support new digital media distribution models and methods to monetize media content;

- Leverage the power of ubiquitous computing to instantly link consumers to a wealth of information and/or interactive experiences related to the media and objects they encounter each day;

- Provide consumers with more choice and access to media content when, where and how they want it;

- Enhance imagery and video by associating metadata or authenticating media content for government and commercial uses; and

- Better secure identity documents to enhance national security and combat identity theft and fraud.

At the core of our intellectual property is a signal processing innovation known as digital watermarking, which allows imperceptible digital information to be embedded in all forms of digitally designed, produced or distributed media content and some physical objects, including photographs, movies, music, television, personal identification documents, financial instruments, industrial parts and product packages. The digital information can be detected and read by a wide range of computers, mobile phones and other digital devices.

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Our technology allows our customers to provide persistent digital identities for any media content that is digitally processed at some point during its lifecycle. The technology can be applied to printed materials, video, audio, and images. The inclusion of these digital signals enables a wide range of improvements in security and media management, and new business models for distribution and consumption of media content. Over the years our technology and intellectual property portfolios have grown to encompass many related technologies.

We provide solutions directly and through our licensees. Our proprietary technology has proven to be a powerful element of document security, giving rise to our long-term relationship with a consortium of central banks ( Central Banks ), and many leading companies in the information technology industry. We and our licensees have successfully propagated the use of our technology in music, movies, television broadcasts, images and printed materials. Digimarc IDs have been used in these applications to improve media rights and asset management, reduce piracy and counterfeiting losses, improve marketing programs, permit more efficient and effective distribution of valuable media content and enhance consumer entertainment and commercial experiences.

Digimarc IDs are easily embedded into all forms of media and are imperceptible to human senses, but quickly detected by computers, networks or other digital devices like smartphones. Unlike traditional barcodes and tags, our solution does not require publishers to give up valuable space in magazines and newspapers; nor does it impact the overall layout or aesthetics of the publication. Our Digimarc Discover platform delivers a range of rich media experiences to its readers on their smartphones across multiple media including print, audio, video and packaging. Unique to the Digimarc Discover platform is its ability to use various content identification technologies as needed, including our patented technology.

We introduced Digimarc Barcodes as a feature of Digimarc Discover in 2014 for use in consumer product packaging. Digimarc Barcodes contain the same information found in traditional universal product codes ( UPC ). The UPC information is invisibly repeated multiple times over the entire package surface. We partnered with Datalogic, a global leader in Automatic Data Capture and Industrial Automation markets and producer of barcode readers, in bringing the Digimarc Barcode to the market. The first retail scanner enabled was Datalogic s Magellan™ 9800i multi-plane imaging scanner. Digimarc Barcodes can also connect mobile-enabled consumers directly from packaging to engaging mobile experiences such as additional product information, special offers, recommendations, reviews, social networks and more.

Our patent portfolio contains a number of innovations in digital watermarking, pattern recognition (sometimes referred to as fingerprinting ), digital rights management and related fields. To protect our significant efforts in creating our technology, we have implemented an extensive intellectual property protection program that relies on a combination of patent, copyright, trademark and trade secret laws, and nondisclosure agreements and other contracts. As a result, we believe we have one of the world s most extensive patent portfolios in digital watermarking and related fields, with more than 1,200 U.S. and foreign patents and pending patent applications as of March 31, 2015. We continue to develop and broaden our portfolio of patented technology in the fields of media identification and management technology and related applications and systems. We devote significant resources to developing and protecting our inventions and continuously seek to identify and evaluate potential licensees for our patents. The patents in our portfolio have a life of approximately 20 years from the effective filing date, and up to 17 years after the patent has been granted.

As part of our intellectual property marketing and patent monetization efforts, our key objectives in building relationships with potential customers and partners are to:

- make progress toward the realization of our vision to enrich everyday living via pervasive, intuitive computing;
- expand the scope of our license program;
- effectively monetize our patent assets;
- encourage large scale adoption of our technologies by industry leaders;
- improve our financial performance;
- increase the scale and rate of growth of our products and services business; and
- lay a foundation for continuing innovation.

For a discussion of activities and costs related to our research and development, read the section titled Results of Operations Summary Research, development and engineering.

**Critical Accounting Policies and Estimates**

Detailed information on our critical accounting policies and estimates are set forth in our 2014 Annual Report in Part II, Item 7 thereof ( Management s Discussion and Analysis of Financial Condition and Results of Operations ), under the caption Critical Accounting Policies and Estimates, which is incorporated by reference into this Quarterly Report on Form 10-Q.

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**Results of Operations**

The following table presents statements of operations data for the periods indicated as a percentage of total revenue. Unless otherwise indicated, all references in this Management s Discussion and Analysis of Financial Condition and Results of Operations to the three-month period relate to the three-month period ended March 31, 2015 and all changes discussed with respect to such period reflect changes compared to the three-month period ended March 31, 2014.

| | Three Months Ended March 31, 2015 |
|---|---|