

Digimarc CORP
Form 10-Q
May 02, 2019

d'

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 March 31, 2019

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 (I.R.S. Employer

incorporation or organization) Identification No.)

9405 SW Gemini Drive, Beaverton, Oregon 97008

Edgar Filing: Digimarc CORP - Form 10-Q

(Address of principal executive offices) (Zip Code)

(503) 469-4800

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol	Name of Each Exchange on Which Registered
Common Stock, \$0.001 Par Value Per Share	DMRC	The NASDAQ Stock Market LLC

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

<input type="checkbox"/> Large accelerated filer	<input type="checkbox"/> Accelerated filer
<input type="checkbox"/> Non-accelerated filer	<input type="checkbox"/> Smaller reporting company
<input type="checkbox"/> 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

As of April 26, 2019, there were 12,127,967 shares of the registrant's common stock, par value \$0.001 per share, outstanding.

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. <u>Financial Statements (Unaudited):</u>	3
<u>Consolidated Balance Sheets as of March 31, 2019 and December 31, 2018</u>	3
<u>Consolidated Statements of Operations for the three months ended March 31, 2019 and 2018</u>	4
<u>Consolidated Statements of Shareholders' Equity for the three months ended March 31, 2019 and 2018</u>	5
<u>Consolidated Statements of Cash Flows for the three months ended March 31, 2019 and 2018</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 4. <u>Controls and Procedures</u>	29

PART II OTHER INFORMATION

Item 1. <u>Legal Proceedings</u>	30
Item 1A. <u>Risk Factors</u>	30
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
Item 6. <u>Exhibits</u>	31
<u>SIGNATURES</u>	32

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.
DIGIMARC CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

(UNAUDITED)

	March 31, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$24,275	\$ 27,278
Marketable securities	13,193	16,378
Trade accounts receivable, net	3,727	3,888
Other current assets	2,026	2,100
Total current assets	43,221	49,644
Property and equipment, net	3,808	3,955
Intangibles, net	6,649	6,649
Goodwill	1,114	1,114
Other assets	3,167	425
Total assets	\$57,959	\$ 61,787
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and other accrued liabilities	\$2,337	\$ 1,092
Deferred revenue	2,700	3,226
Total current liabilities	5,037	4,318
Lease liability and other long-term liabilities	3,079	854
Total liabilities	8,116	5,172
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, 2019 and December 31, 2018)	50	50
Common stock (par value \$0.001 per share, 50,000 authorized, 12,135 and		
11,891 shares issued and outstanding at March 31, 2019 and December 31, 2018,		
respectively)	12	12
Additional paid-in capital	164,119	162,428

Accumulated deficit	(114,338)	(105,875)
Total shareholders' equity	49,843	56,615
Total liabilities and shareholders' equity	\$57,959	\$ 61,787

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

DIGIMARC CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(UNAUDITED)

	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Revenue:		
Service	\$ 3,635	\$ 3,507
Subscription	1,563	1,578
License	462	528
Total revenue	5,660	5,613
Cost of revenue:		
Service	1,531	1,563
Subscription	445	482
License	158	140
Total cost of revenue	2,134	2,185
Gross profit	3,526	3,428
Operating expenses:		
Sales and marketing	4,950	4,887
Research, development and engineering	4,038	3,947
General and administrative	2,852	2,632
Intellectual property	358	315
Total operating expenses	12,198	11,781
Operating loss	(8,672)	(8,353)
Other income, net	237	252
Loss before income taxes	(8,435)	(8,101)
Provision for income taxes	(28)	(11)
Net loss	\$ (8,463)	\$ (8,112)
Earnings (loss) per common share:		
Loss per common share — basic	\$ (0.74)	\$ (0.72)
Loss per common share — diluted	\$ (0.74)	\$ (0.72)
Weighted average common shares outstanding — basic	11,487	11,266
Weighted average common shares outstanding — diluted	11,487	11,266

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

DIGIMARC CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands)

(UNAUDITED)

	Preferred Stock Shares	Amount	Common Stock Shares	Amount	Additional Paid-in Capital	Accumulated Deficit	Total Shareholders' Equity
Three months ended March 31, 2018:							
BALANCE AT DECEMBER 31, 2017	10	\$ 50	11,651	\$ 12	\$ 155,793	\$ (73,508)	\$ 82,347
Exercise of stock options	—	—	46	—	560	—	560
Issuance of restricted common stock	—	—	178	—	—	—	—
Forfeiture of restricted common stock	—	—	(10)	—	—	—	—
Purchase and retirement of common stock	—	—	(18)	—	(528)	—	(528)
Stock-based compensation	—	—	—	—	1,715	—	1,715
Cumulative effect of the adoption of the new revenue standard, net of tax	—	—	-	—	—	139	139
Net loss	—	—	—	—	—	(8,112)	(8,112)
BALANCE AT MARCH 31, 2018	10	\$ 50	11,847	\$ 12	\$ 157,540	\$ (81,481)	\$ 76,121
Three months ended March 31, 2019:							
BALANCE AT DECEMBER 31, 2018	10	\$ 50	11,891	\$ 12	\$ 162,428	\$ (105,875)	\$ 56,615
Exercise of stock options	—	—	10	—	99	—	99
Issuance of restricted common stock	—	—	255	—	—	—	—
Forfeiture of restricted common stock	—	—	(1)	—	—	—	—
Purchase and retirement of common stock	—	—	(20)	—	(486)	—	(486)
Stock-based compensation	—	—	—	—	2,078	—	2,078
Net loss	—	—	—	—	—	(8,463)	(8,463)
BALANCE AT MARCH 31, 2019	10	\$ 50	12,135	\$ 12	\$ 164,119	\$ (114,338)	\$ 49,843

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

DIGIMARC CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(UNAUDITED)

	Three Months Ended March 31, 2019	Three Months Ended March 31, 2018
Cash flows from operating activities:		
Net loss	\$ (8,463)	\$ (8,112)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation, amortization and write-off of property and equipment	357	380
Amortization and write-off of intangibles	180	146
Stock-based compensation	2,037	1,671
Changes in operating assets and liabilities:		
Trade accounts receivable	161	2,614
Other current assets	74	304
Other assets	(33)	44
Accounts payable and other accrued liabilities	800	(386)
Deferred revenue	(393)	(219)
Lease liability and other long-term liabilities	(174)	(34)
Net cash used in operating activities	(5,454)	(3,592)
Cash flows from investing activities:		
Purchase of property and equipment	(194)	(302)
Capitalized patent costs	(153)	(208)
Maturity of marketable securities	6,744	18,657
Purchase of marketable securities	(3,559)	(6,961)
Net cash provided by investing activities	2,838	11,186
Cash flows from financing activities:		
Exercise of stock options	99	560
Purchase of common stock	(486)	(528)
Net cash provided by (used in) financing activities	(387)	32
Net increase (decrease) in cash and cash equivalents	(3,003)	7,626
Cash and cash equivalents at beginning of period	27,278	40,823
Cash and cash equivalents at end of period	\$ 24,275	\$ 48,449
Supplemental disclosure of cash flow information:		
Cash received (paid) for income taxes, net	\$ (3)	\$ 113
Supplemental schedule of non-cash activities:		
Property and equipment and patent costs in accounts payable	\$ 2	\$ (64)
Stock-based compensation capitalized to software and patent costs	\$ 41	\$ 44

Edgar Filing: Digimarc CORP - Form 10-Q

Right of use assets obtained in exchange for lease obligations	\$ 2,709	\$ —
--	----------	------

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

6

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, banks, retailers, consumer brands and other businesses around the world to automatically and reliably identify and interact with virtually any form of media. The Company has pioneered the Digimarc Intuitive Computing Platform (“ICP”), a comprehensive set of technologies for identifying, discovering and interacting with digitally-enhanced media. The platform includes Digimarc Barcode, a proprietary method for imperceptibly enhancing packaging, print, images, thermal labels, audio and other objects with data that is detected by enabled devices, such as smart phones, computers, barcode scanners and machine-vision equipment. Digimarc Discover software enables an ecosystem of connected devices to easily identify content or materials and deliver information.

Interim Consolidated Financial Statements

Our significant accounting policies are detailed in “Note 1: Description of Business and Summary of Significant Accounting Policies” of our Annual Report on Form 10-K for the year ended December 31, 2018. Significant changes to our accounting policies as a result of adopting Accounting Standards Codification (“ASC”) 842, “Leases,” effective January 1, 2019, is discussed in Note 10 below.

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 (“U.S. GAAP”) have been condensed or omitted in accordance with the rules and regulations of the U.S. 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, 2018, which was filed with the SEC on February 22, 2019. 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.

Contingencies

The Company evaluates all pending or threatened contingencies or commitments, if any, that are reasonably likely to have a material adverse effect on the Company's operations or financial position. The Company assesses the probability of an adverse outcome and determines if it is remote, reasonably possible or probable as defined in accordance with the provisions of ASC 450, "Contingencies." If information available prior to the issuance of the financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements, and the amount of the loss, or the range of probable loss can be reasonably estimated, then the loss is accrued and charged to operations. If no accrual is made for a loss contingency because one or both of the conditions pursuant to ASC 450 are not met, but the probability of an adverse outcome is at least reasonably possible, the Company will disclose the nature of the contingency and provide an estimate of the possible loss or range of loss, or state that such an estimate cannot be made.

Goodwill

The Company tests goodwill for impairment annually in June and whenever events or changes in circumstances indicate that the carrying value may exceed the fair value. The Company operates as a single reporting unit. The Company estimates the fair value of its single reporting unit using a market approach, which takes into account the Company's market capitalization plus an estimated control premium.

Accounting Pronouncements Adopted

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, “Leases (ASC 842),” which supersedes, “Leases (ASC 840).” ASU No. 2016-02 increases the transparency and comparability of organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This guidance requires that operating leases recognize a right-of-use asset and a lease liability measured at the present value of the lease payments in the statement of financial position, recognize a single lease cost allocated over the lease term on a straight-line basis, and classify all cash payments within operating activities in the statement of cash flows. The amendments in this update are effective for fiscal years beginning after December 31, 2018, and interim periods beginning in the first interim period within the year of adoption. Early adoption is permitted. In July 2018, the FASB issued ASU No. 2018-11, “Leases (ASC 842) Targeted Improvements,” to provide a transition election to not restate comparative periods for the effects of applying the new standard. This transition election permits entities to change the date of initial application to the beginning of the year of adoption and to recognize the effects of applying the new standard as a cumulative-effect adjustment to the opening balance of retained earnings. In March 2019, the FASB issued ASU No. 2019-01, “Leases (ASC 842) Codification Improvements,” to increase transparency and comparability about disclosing essential information about leasing transactions. The Company adopted the new standard on January 1, 2019 and elected not to restate comparative periods. Upon adoption, the Company concluded no adjustment was required to the opening balance of retained earnings to reflect the impact of adopting the new standard. In addition, the Company recorded right of use assets of \$2,709 and lease liabilities of \$3,792 and reversed the previously recorded deferred rent liability of \$1,083. See Note 10 below for further disclosures.

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’s marketable securities are classified as held-to-maturity and are reported at amortized cost, which approximates fair value.

The Company’s fair value hierarchy for its cash equivalents and marketable securities was as follows:

	Level	Level	Level	Total
March 31, 2019	1	2	3	
Money market securities	\$ 323	\$—	\$ —	\$323
Commercial paper	—	28,725	—	28,725
Corporate notes	—	7,733	—	7,733
Total	\$ 323	\$36,458	\$ —	\$36,781

	Level	Level	Level	Total
December 31, 2018	1	2	3	
Money market securities	\$1,472	\$—	\$ —	\$1,472
Commercial paper	—	28,343	—	28,343

Edgar Filing: Digimarc CORP - Form 10-Q

Corporate notes	—	12,106	—	12,106
Total	\$1,472	\$40,449	\$	—\$41,921

The fair value maturities of the Company's cash equivalents and marketable securities as of March 31, 2019 are as follows:

	Maturities by Period			
	Less than	1-5	5 - 10	More than
	Total	1 year	years	years
Cash equivalents and marketable securities	\$36,781	\$		10 years