

CLEARONE COMMUNICATIONS INC

Form 10-Q

November 15, 2012

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, 2012

or

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

For the transition period _____ to _____

Commission file number: 001-33660

CLEARONE COMMUNICATIONS, INC.

(Exact name of registrant as specified in its charter)

Utah

(State or other jurisdiction of incorporation or organization)

5225 Wiley Post Way, Suite 500, Salt Lake City, Utah

(Address of principal executive offices)

(801) 975-7200

(Registrant's telephone number, including area code)

87-0398877

(I.R.S. employer identification number)

84116

(Zip Code)

Indicate by check 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 (§232.405 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

See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Larger 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

APPLICABLE ONLY TO CORPORATE ISSUERS:

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 9,193,552 shares issued and outstanding as of November 12, 2012.

CLEARONE COMMUNICATIONS, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2012

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PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CLEARONE COMMUNICATIONS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except par value)

| | September 30, 2012 Unaudited | December 31, 2011 |
|--|---------------------------------|-------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$14,332 | \$16,683 |
| Receivables, net of allowance for doubtful accounts of \$64 and \$149, respectively | 7,667 | 8,457 |
| Inventories | 11,992 | 12,565 |
| Deferred income taxes | 3,025 | 2,987 |
| Prepaid expenses and other assets | 1,448 | 740 |
| Total current assets | 38,464 | 41,432 |
| Long-term inventories, net | 2,432 | 1,905 |
| Property and equipment, net | 1,971 | 2,338 |
| Intangibles, net | 5,636 | 2,690 |
| Goodwill | 1,939 | 1,153 |
| Other assets | 64 | 41 |
| Total assets | \$50,506 | \$49,559 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$1,411 | \$2,814 |
| Accrued liabilities | 2,568 | 2,534 |
| Deferred product revenue | 3,545 | 3,404 |
| Total current liabilities | 7,524 | 8,752 |
| Deferred income taxes | 128 | 101 |
| Deferred rent | 454 | 494 |
| Other long-term liabilities | 686 | 548 |
| Total liabilities | 8,792 | 9,895 |
| Shareholders' equity: | | |
| Common stock, par value \$0.001, 50,000,000 shares authorized, 9,191,099 and 9,098,152 shares issued and outstanding | 9 | 9 |
| Additional paid-in capital | 40,550 | 40,073 |
| Treasury stock at cost - 94,744 shares as of September 30, 2012 | (384 |) — |
| Retained earnings (accumulated deficit) | 1,539 | (418 |
| Total shareholders' equity | 41,714 | 39,664 |
| Total liabilities and shareholders' equity | \$50,506 | \$49,559 |

See accompanying notes

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CLEARONE COMMUNICATIONS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenue | \$11,573 | \$11,511 | \$33,382 | \$34,102 |
| Cost of goods sold | 4,856 | 4,534 | 13,464 | 13,666 |
| Gross profit | 6,717 | 6,977 | 19,918 | 20,436 |
| Operating expenses: | | | | |
| Sales and marketing | 1,821 | 2,184 | 6,209 | 6,274 |
| Research and product development | 1,959 | 1,796 | 5,996 | 5,249 |
| General and administrative | 1,545 | 1,333 | 4,736 | 4,166 |
| Proceeds from litigation | — | (3,702) | (250) | (3,702) |
| Total operating expenses | 5,325 | 1,611 | 16,691 | 11,987 |
| Operating income | 1,392 | 5,366 | 3,227 | 8,449 |
| Other income (expense), net | 29 | (4) | 40 | 15 |
| Income before income taxes | 1,421 | 5,362 | 3,267 | 8,464 |
| Provision for income taxes | 492 | 1,987 | 1,310 | 2,956 |
| Net income | \$929 | \$3,375 | \$1,957 | \$5,508 |
| Basic earnings per common share | \$0.10 | \$0.37 | \$0.21 | \$0.61 |
| Diluted earnings per common share | \$0.10 | \$0.36 | \$0.21 | \$0.59 |
| Basic weighted average shares outstanding | 9,113,713 | 9,089,919 | 9,106,455 | 9,005,221 |
| Diluted weighted average shares outstanding | 9,193,574 | 9,358,292 | 9,219,161 | 9,276,619 |

See accompanying notes

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CLEARONE COMMUNICATIONS, INC.
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Dollars in thousands)

| | Nine months ended September 30, | |
|---|------------------------------------|------------|
| | 2012 | 2011 |
| Cash flows from operating activities: | | |
| Net income | \$1,957 | \$5,508 |
| Adjustments to reconcile net income to net cash provided by operations: | | |
| Depreciation and amortization expense | 1,166 | 872 |
| Stock-based compensation | 176 | 130 |
| Provision for doubtful accounts | 6 | 199 |
| Increase (decrease) in reserves against inventories | 278 | (166) |
| Loss on disposal of assets | — | 4 |
| Proceeds from litigation | — | (3,702) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 784 | 1,179 |
| Inventories | 88 | (1,750) |
| Deferred income taxes | (11 |) 1,418 |
| Prepaid expenses and other assets | 336 | (281) |
| Accounts payable | (1,403 |) (53) |
| Income taxes payable | (1,155 |) 958 |
| Accrued liabilities | 123 | (1,768) |
| Deferred product revenue | 141 | (602) |
| Other long-term assets and liabilities | 138 | 88 |
| Net cash provided by operating activities | 2,624 | 2,034 |
| Cash flows from investing activities: | | |
| Payment towards acquisition of VCON business | (4,632 |) — |
| Payment towards acquisition of MagicBox business | — | (750) |
| Purchase of property and equipment | (260 |) (309) |
| Net cash used in investing activities | (4,892 |) (1,059) |
| Cash flows from financing activities: | | |
| Proceeds from the issuance of common stock - options | 301 | 732 |
| Treasury stock purchased | (384 |) — |
| Net cash provided by (used in) financing activities | (83 |) 732 |
| Net increase (decrease) in cash and cash equivalents | (2,351 |) 1,707 |
| Cash and cash equivalents at the beginning of the period | 16,683 | 11,431 |
| Cash and cash equivalents at the end of the period | \$14,332 | \$13,138 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | \$1,393 | \$274 |

See accompanying notes

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CLEARONE COMMUNICATIONS, INC.
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Dollars in thousands)

| | Nine months ended September 30, | |
|--|------------------------------------|-------|
| | 2012 | 2011 |
| Supplemental disclosure of non-cash activities: | | |
| Exchanged accounts receivable from a vendor with accounts payable to the same vendor | \$— | \$182 |
| The Company acquired the business of VCON Video Conferencing, Ltd. in February 2012 and recorded the following assets and liabilities: | | |
| Inventory | \$320 | \$— |
| Property and equipment | 34 | — |
| Product warranty liability | (8 |) — |
| Tradenname | 500 | — |
| Patents and technological know-how | 2,300 | — |
| Proprietary software | 500 | — |
| In-process research and development | 200 | — |
| Goodwill | 786 | — |
| Cash paid | \$4,632 | \$— |
| The Company acquired the business of MagicBox, Inc. in September 2011 and recorded the following assets and liabilities: | | |
| Accounts receivable | \$— | \$81 |
| Inventory | — | 117 |
| Other current assets | — | 12 |
| Accrued liabilities | — | (4 |
| Property and equipment | — | 9 |
| Proprietary software | — | 665 |
| In-process research and development | — | 75 |
| Tradenname | — | 25 |
| Cash paid | \$— | \$980 |

See accompanying notes

CLEARONE COMMUNICATIONS, INC.
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited – Dollars in thousands)

1. Business Description, Basis of Presentation and Significant Accounting Policies

Business Description:

ClearOne Communications, Inc. and its subsidiaries (collectively, “ClearOne” or the “Company”) is a global company that designs, develops and sells conferencing, collaboration, streaming and digital signage solutions for audio, video and data multimedia communication. The performance and simplicity of its advanced comprehensive solutions enhance the quality of life. ClearOne products are designed for business and residential use, offering unprecedented levels of functionality, reliability and scalability.

Basis of Presentation:

The fiscal year for ClearOne is the 12 months ending on December 31st. The consolidated financial statements include the accounts of ClearOne and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

These accompanying interim condensed consolidated financial statements for the three and nine months ended September 30, 2012 and 2011 respectively have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and are not audited. Certain information and footnote disclosures that are usually included in financial statements prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) have been either condensed or omitted in accordance with SEC rules and regulations. The accompanying consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of our financial position as of September 30, 2012 and December 31, 2011, the results of operations for the three and nine months ended September 30, 2012 and 2011, and the statements of cash flows for the nine months ended September 30, 2012 and 2011. The results of operations for the three and nine months ended September 30, 2012 and 2011 are not necessarily indicative of the results for a full-year period. These interim condensed consolidated financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the SEC.

Significant Accounting Policies:

The significant accounting policies were described in Note 2 to the audited consolidated financial statements included in the Company’s annual report on Form 10-K for the year ended December 31, 2011. There have been no significant changes to these policies during the nine months ended September 30, 2012 that are of significance or potential significance to the Company.

Warranty Costs – The Company accrues for warranty costs based on estimated warranty return rates and estimated costs to repair. Factors that affect the Company’s warranty liability include the number of units sold, historical and anticipated rates of warranty returns, and repair cost. The Company reviews the adequacy of its recorded warranty accrual on a quarterly basis.

The details of changes in the Company’s warranty accrual are as follows:

| | September 30, 2012 | December 31, 2011 |
|----------------------------------|--------------------|-------------------|
| Balance at the beginning of year | \$467 | \$363 |
| Accruals/additions | 234 | 439 |

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| | | | |
|--------------------------|-------|--------|---|
| Usage | (264 |) (335 |) |
| Balance at end of period | \$437 | \$467 | |

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CLEARONE COMMUNICATIONS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited – Dollars in thousands)

Earnings Per Share – The following table sets forth the computation of basic and diluted earnings per common share:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|----------------------------------|-----------|---------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Numerator: | | | | |
| Net income | \$929 | \$3,375 | \$1,957 | \$5,508 |
| Denominator: | | | | |
| Basic weighted average shares | 9,113,713 | 9,089,919 | 9,106,455 | 9,005,221 |
| Dilutive common stock equivalents using treasury stock method | 79,861 | 268,373 | 112,706 | 271,398 |
| Diluted weighted average shares | 9,193,574 | 9,358,292 | 9,219,161 | 9,276,619 |
| Basic earnings per common share: | \$0.10 | \$0.37 | \$0.21 | \$0.61 |
| Diluted earnings per common share: | \$0.10 | \$0.36 | \$0.21 | \$0.59 |
| Weighted average options outstanding | 1,215,747 | 1,067,717 | 1,195,599 | 1,135,514 |
| Anti-dilutive options not included in the computations | 799,203 | 374,611 | 799,203 | 374,611 |

2. Business Combination

On February 16, 2012, the Company completed the acquisition of the video conferencing business of Israel-based VCON Video Conferencing, Ltd. (“VCON”) through an asset purchase agreement. VCON is a pioneer in software based video conferencing solutions with product offerings that include group video conferencing endpoints, desktop video conferencing endpoints, video conferencing infrastructure solutions and software development kits. This acquisition and the combination of streaming and digital signage technologies will provide us with complementary technology opportunities allowing us to enter new growth markets.

Pursuant to the asset purchase agreement, the Company paid initial consideration of \$4,632 in cash. This initial consideration is subject to a final working capital adjustment.

The estimated fair values of assets acquired and liabilities assumed are preliminary and are based on the information that was available as of the acquisition date to estimate the fair value of assets acquired and liabilities assumed. The Company believes that such information provides a reasonable basis for estimating the fair values of assets acquired and liabilities assumed, but the Company is waiting for additional information necessary to finalize those fair values. The measurement period for purchase price allocation ends as soon as information on the facts and circumstances becomes available, but will not exceed twelve months from the date of acquisition. Adjustments in the purchase price allocation may require a recasting of the amounts allocated to intangible assets and possible allocation to goodwill, retroactive to the period in which the acquisition occurred. Therefore, the preliminary measurements of fair value reflected are subject to change and any such changes could be significant.

The preliminary fair value of identified assets and liabilities acquired and goodwill is as follows:

| | |
|------------------------|--------|
| Inventory | \$ 320 |
| Property and equipment | 34 |

| | | |
|-------------------------------------|---------|---|
| Product warranty liability | (8 |) |
| Tradename | 500 | |
| Patents and technology | 2,300 | |
| Proprietary software | 500 | |
| In-process research and development | 200 | |
| Goodwill | 786 | |
| | \$4,632 | |

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CLEARONE COMMUNICATIONS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited – Dollars in thousands)

The Company incurred \$44 and \$270 towards acquisition related expenses, all of which are categorized under general and administrative expenses in the condensed consolidated statements of operations for the three and nine months ended September 30, 2012, respectively.

Supplemental Pro Forma information

- 1) Revenue and net loss from the VCON business from February 16, 2012 to September 30, 2012 was \$720 and (\$773), respectively.
- 2) Revenue and earnings of the combined entity as though the business combination occurred as of January 1, 2011 is as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|------------|----------------------------------|----------|---------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenue | \$11,573 | \$11,886 | \$33,595 | \$35,249 |
| Net income | 929 | 3,152 | 1,913 | 5,115 |

- 3) There were no material, nonrecurring pro forma adjustments directly attributable to the acquisition included in this supplemental Pro Forma information.

3. Goodwill and Intangibles

Goodwill

The goodwill of \$786 related to the acquisition of VCON is comprised of expected synergies in utilizing VCON technology in ClearOne product offerings, reduction in future combined research and development expenses, and intangible assets including acquired workforce that do not qualify for separate recognition. The goodwill balance of \$786 related to the acquisition of the VCON business is deductible for tax purposes.

Intangible Assets

Intangible assets as of September 30, 2012 and December 31, 2011 consisted of the following:

| | Estimated useful lives | September 30, 2012 | December 31, 2011 |
|-------------------------------------|------------------------|--------------------|-------------------|
| Tradenname | 7 years | \$935 | \$435 |
| Patents and technology | 10 years | 4,370 | 2,070 |
| Proprietary software | 3 to 5 years | 894 | 394 |
| In-process research and development | Indefinite | 759 | 559 |
| Other | 5 years | 49 | 49 |
| | | 7,007 | 3,507 |
| Accumulated amortization | | (1,371) | (817) |
| | | \$5,636 | \$2,690 |

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|----------------------------------|------|---------------------------------|-------|
| | 2012 | 2011 | 2012 | 2011 |
| Amortization of intangibles with finite lives | \$222 | \$87 | \$554 | \$263 |

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CLEARONE COMMUNICATIONS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited – Dollars in thousands)

The estimated future amortization expense of intangible assets is as follows:

| | |
|---------------------------|---------|
| Years ending December 31, | |
| 2012 (remainder) | \$208 |
| 2013 | 799 |
| 2014 | 782 |
| 2015 | 598 |
| 2016 | 560 |
| 2017 | 508 |
| Thereafter | 1,422 |
| | \$4,877 |

4. Inventories

Inventories, net of reserves, as of September 30, 2012 and December 31, 2011 consisted of the following:

| | September 30, 2012 | December 31, 2011 |
|----------------|-----------------------|----------------------|
| Current: | | |
| Raw materials | \$867 | \$1,091 |
| Finished goods | 11,125 | 11,474 |
| | \$11,992 | \$12,565 |
| Long-term: | | |
| Raw materials | \$650 | \$444 |
| Finished goods | 1,782 | 1,461 |
| | \$2,432 | \$1,905 |

Long-term inventory represents inventory held in excess of our current requirements for the next 12 months based on our recent sales and forecasted level of sales. We expect to sell the above inventory, net of reserves, at or above the stated cost and believe that no loss will be incurred on its sale.

Current finished goods include consigned inventory in the amounts of approximately \$1,270 and \$1,199 as of September 30, 2012 and December 31, 2011, respectively. Consigned inventory represents inventory at distributors and other customers where revenue recognition criteria have not yet been achieved.

The following table summarizes the losses incurred on valuation of inventory at lower of cost or market value and write-off of obsolete inventory during the three and nine months ended September 30, 2012 and 2011, respectively.

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|------|------------------------------------|------|
| | 2012 | 2011 | 2012 | 2011 |
| Losses incurred on valuation of inventory and write-off of obsolete inventory | \$— | \$— | \$278 | \$— |

CLEARONE COMMUNICATIONS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited – Dollars in thousands)

5. Share-based Compensation

Share-based compensation expense has been recorded as follows:

| | Three months ended September | | Nine months ended September | |
|----------------------------------|------------------------------|------|-----------------------------|-------|
| | 30, 2012 | 2011 | 30, 2012 | 2011 |
| Cost of goods sold | \$2 | \$— | \$3 | \$— |
| Sales and marketing | 15 | 4 | 45 | 14 |
| Research and product development | 9 | 4 | 26 | 12 |
| General and administrative | 39 | 40 | 102 | 105 |
| | \$65 | \$48 | \$176 | \$131 |

As of September 30, 2012, the total remaining unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately \$680, which will be recognized over a weighted average period of 2.95 years.

During the three and nine months ended September 30, 2012, we granted 92,000 and 187,000 stock options, respectively. During the three and nine months ended September 30, 2011, we granted 96,611 and 101,611 stock options, respectively. We use judgment in determining the fair value of the share-based payments on the date of grant using an option-pricing model with assumptions regarding a number of highly complex and subjective variables. These variables include the risk-free interest rate of the awards, the expected life of the awards, the expected volatility over the term of the awards, the expected dividends of the awards, and an estimate of the amount of awards that are expected to be forfeited. We use the Black-Scholes option pricing model to determine the fair value of share-based payments granted under ASC Topic 718.

In applying the Black-Scholes methodology to the options granted, the Company used the following assumptions:

| | Three months ended September | | Nine months ended September | |
|---------------------------------------|------------------------------|-----------|-----------------------------|-----------|
| | 30, 2012 | 2011 | 30, 2012 | 2011 |
| Risk-free interest rate, average | 1.1% | 1.4% | 1.3% | 1.7% |
| Expected option life, average | 7.3 years | 7.1 years | 7.2 years | 7.0 years |
| Expected price volatility, average | 51.1% | 51.9% | 51.4% | 51.8% |
| Expected dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |
| Weighted average per share fair value | \$2.13 | \$3.35 | \$2.19 | \$3.16 |

6. Shareholders' Equity

The following table summarizes the change in shareholders' equity during the three and nine months ended September 30, 2012 and 2011, respectively:

| | Three months ended September | | Nine months ended September | |
|--|------------------------------|----------|-----------------------------|----------|
| | 30, 2012 | 2011 | 30, 2012 | 2011 |
| Balance at the beginning of the period | \$40,792 | \$34,668 | \$39,664 | \$31,735 |

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| | | | | |
|------------------------------|----------|----------|----------|----------|
| Net income during the period | 929 | 3,375 | 1,957 | 5,508 |
| Treasury stock purchased | (292 |) — | (384 |) — |
| Stock-based compensation | 65 | 48 | 176 | 131 |
| Exercise of stock options | 220 | 14 | 301 | 731 |
| Balance at end of the period | \$41,714 | \$38,105 | \$41,714 | \$38,105 |

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CLEARONE COMMUNICATIONS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

7. Proceeds from Litigation

During the nine months ended September 30, 2012, \$250 was received as a settlement of amounts due from a defendant in our litigation related to the “Theft of Intellectual Property and Related Cases” described in detail in Note 8 – Commitments and Contingencies of the Notes to the Consolidated Financial Statements in our Form 10-K for the year ended December 31, 2011, and updated in our subsequent Form 10-Qs.

8. Income Taxes

The Company’s forecasted effective tax rate at September 30, 2012 is 37.7%, a 3.1 percentage-point increase from the 34.6% effective tax rate recorded at December 31, 2011. The increase is primarily attributable to the expiration of the U.S. research and development credit on December 31, 2011. The effective tax rate recorded for the quarter ending September 30, 2012 is 34.6%. The difference between the forecasted effective tax rate and the rate recorded is primarily due to discrete items related to benefit from federal return-to-provision true-up.

Accrued liabilities as of September 30, 2012 and December 31, 2011 include accrued income taxes payable of \$304 and \$300, respectively.

9. Commitments and Contingencies

The Company entered into a consulting arrangement for a period of 12 months for transition-related work with respect to our VCON acquisition. The consulting arrangement provides for a fixed fee of approximately \$180 with additional maximum incentive-based fees of approximately \$20 associated with accomplishing specific milestones.

10. Subsequent Events

The Company evaluated its consolidated financial statements as of and for the three and nine months ended September 30, 2012 for subsequent events through the date the financial statements were issued. The Company is not aware of any subsequent event which would require recognition or disclosure in the financial statements.

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

This report on Form 10-Q includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). All statements in this report, other than statements of historical fact, are forward-looking statements for purposes of these provisions, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance, and any statements of assumptions underlying any of the foregoing. All forward-looking statements included in this report are made as of the date hereof and are based on information available to us as of such date. We assume no obligation to update any forward-looking statement. In some cases, forward-looking statements can be identified by the use of terminology such as “may,” “will,” “expects,” “plans,” “anticipates,” “intends,” “believes,” “estimates,” “potential,” or “continue,” or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that any such expectations or any forward-looking statement will prove to be correct. Our actual results will vary, and may vary materially, from those projected or assumed in the forward-looking statements. Future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including, without limitation, product recalls and product liability claims; infringement of our technology or assertion that our technology infringes the rights of other parties; termination of supplier relationships, or failure of suppliers to perform; inability to successfully manage growth; delays in obtaining regulatory approvals or the failure to maintain such approvals; concentration of our revenue among a few customers, products or procedures; development of new products and technology that could render our products obsolete; market acceptance of new products; introduction of products in a timely fashion; price and product competition, availability of labor and materials, cost increases, and fluctuations in and obsolescence of inventory; volatility of the market price of our common stock; foreign currency fluctuations; changes in key personnel; work stoppage or transportation risks; and other factors referred to in our press releases and reports filed with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2011. All subsequent forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Additional factors that may have a direct bearing on our operating results are discussed in Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2011.

BUSINESS OVERVIEW

ClearOne is a global company that designs, develops and sells conferencing, collaboration, streaming and digital signage solutions for audio, video and data multimedia communication. The performance and simplicity of its advanced comprehensive solutions enhance the quality of life.

We develop, manufacture, market, and service a comprehensive line of high-quality audio conferencing products for personal use as well as traditional tabletop, mid-tier premium and higher end professional products for both large and small businesses. We occupy the number one global market share position, with nearly 50% market share in the professional audio conferencing market for professional products used by large businesses and organizations such as enterprise, healthcare, education and distance learning, government, legal and finance organizations. Our conferencing solutions save organizations time and money by creating a natural environment for collaboration.

NetStreams® DigilinX, the ClearOne brand for residential multimedia streaming and control, and VIEW™, the ClearOne brand for commercial multimedia streaming and control, deliver a superior IP A/V experience by streaming high definition audio and video (multimedia) and control over TCP/IP LAN networks. NetStreams' technology is used in a wide variety of applications including digital signage, corporate video streaming, network operations centers, distance education, and in venues for hospitality and entertainment, as well as casinos.

ClearOne's products, designed for commercial and residential use, offer outstanding levels of performance, functionality, simplicity, reliability, and scalability. By combining audio and/or video content, meta-data and control signals into one stream over existing Internet Protocol networks in harmony with industry standards, ClearOne's newly patented StreamNet® solutions enable the Power of AV over IP™ for burgeoning markets such as digital signage, enterprise multimedia streaming and home entertainment. Also sold under the NetStreams residential brand are non-IP multimedia distribution solutions for economical multimedia residential streaming applications.

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CLEARONE COMMUNICATIONS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

On September 2, 2011, we acquired the business of Oregon based MagicBox, Inc., a developer and marketer of a variety of hardware and software solutions designed to deliver digital content and information to digital displays. This acquisition significantly broadens ClearOne's current StreamNet offerings and expands its digital signage product portfolio with tools for content and playlist creation and management. The MagicBox content management and its database integration software complement ClearOne's StreamNet systems. The StreamNet and MagicBox technologies are an excellent fit to deliver on the challenging requirements for any digital signage provider to distribute content over a local area network while maintaining content and scheduling alignment. As a result of this acquisition and the combination of StreamNet and Magicbox technologies, we are the only company to offer complete end-to-end digital signage content management, IP streaming, and control solutions.

On February 16, 2012, we acquired the business of Israel based VCON Video Conferencing, Ltd ("VCON") for approximately \$4.6 million in cash. The acquisition presents us with new global market opportunities and will facilitate accelerated product development. VCON is a pioneer in software based video conferencing solutions with product offerings that include group video conferencing endpoints, desktop video conferencing endpoints, video conferencing infrastructure solutions and software development kits. This acquisition and the combination of streaming and digital signage technologies will provide us with complimentary technology opportunities allowing us to enter new growth markets.

Our business goals are to:

- Leverage on the video conferencing, streaming and digital signage technologies we recently acquired to enter new growth markets;
- Maintain our global market share leadership of professional audio conferencing products for large businesses and organizations;
- Focus on the small and medium business (SMB) market with scaled, lower cost and less complex products and solutions;
- Capitalize on the growing adoption of unified communications and introduce new products by entering Information Technology channels;
- Partner with large enterprise communications providers worldwide to bring value added products to their solution portfolios and channels;
- Capitalize on emerging market opportunities as audio visual, information technology, unified communications and traditional digital signage converge to meet enterprise and commercial multimedia needs; and
- Expand and strengthen sales channels.

We will continue to improve our existing high-quality products and develop new products for the burgeoning conferencing and collaboration, and multimedia streaming markets and focus on strategic initiatives to achieve our business goals.

Our revenues were \$11.6 million and \$33.4 million during the three and nine months ended September 30, 2012, respectively, compared to \$11.5 million and \$34.1 million during the three and nine months ended September 30, 2011, respectively. Revenues were essentially flat during the three months ended September 30, 2012 when compared to revenues over the comparable period in 2011. Revenues declined by 2% during the nine months ended September 30, 2012, when compared to revenues over the comparable period in 2011. Our gross profit decreased by \$260,000 and \$518,000 during the three and nine months ended September 30, 2012, respectively, compared to the three and nine months ended September 30, 2011. Net income also decreased by \$2.4 million and \$3.6 million during the three

and nine months ended September 30, 2012, respectively, compared to the three and nine months ended September 30, 2011. Net income for the three months ended September 30, 2012 declined primarily due to the recognition of \$3.7 million proceeds from the litigation against Biamp included in the three months ended September 30, 2011 and due to reduced gross profit margin. Net income for the nine months ended September 30, 2012 declined primarily due to the recognition of \$3.7 million proceeds from the litigation against Biamp included in the nine months ended September 30, 2011 and due to reduced revenue and added costs due to acquisitions.

We expect the recent acquisitions and new product introductions to start contributing to revenue in the near future.

The prospects of growth in both revenues and profits in the near future would depend on the strength of the global economy and the penetration level of our new products, including products added through acquisitions. We continue to closely monitor the global economic events and continue our existing measures to control costs and invest in strategic products and initiatives.

A detailed discussion of our results of operations follows below.

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ANALYSIS OF RESULTS OF OPERATIONS

Results of Operations for the three months ended September 30, 2012, and 2011, and nine months ended September 30, 2012, and 2011

The following table sets forth certain items from our unaudited condensed consolidated statements of operations (dollars in thousands) for the three months ended September 30, 2012 and 2011, respectively, and the nine months ended September 30, 2012 and 2011, respectively, together with the percentage of total revenue which each such item represents:

| | Three months ended September 30, | | | | Nine months ended September 30, | | | |
|----------------------------------|----------------------------------|--------------|----------|--------------|---------------------------------|--------------|----------|--------------|
| | 2012 | % of Revenue | 2011 | % of Revenue | 2012 | % of Revenue | 2011 | % of Revenue |
| Revenue | \$11,573 | 100 % | \$11,511 | 100 % | \$33,382 | 100 % | \$34,102 | 100 % |
| Cost of goods sold | 4,856 | 42 % | 4,534 | 39 % | 13,464 | 40 % | 13,666 | 40 % |
| Gross profit | 6,717 | 58 % | 6,977 | 61 % | 19,918 | 60 % | 20,436 | 60 % |
| Sales and marketing | 1,821 | 16 % | 2,184 | 19 % | 6,209 | 19 % | 6,274 | 18 % |
| Research and product development | 1,959 | 17 % | 1,796 | 16 % | 5,996 | 18 % | 5,249 | 15 % |
| General and administrative | 1,545 | 13 % | 1,333 | 12 % | 4,736 | 14 % | 4,166 | 12 % |
| Proceeds from litigation | — | — % | (3,702) | (32) % | (250) | (1) % | (3,702) | (11) % |
| Operating income | 1,392 | 12 % | 5,366 | 47 % | 3,227 | 10 % | 8,449 | 25 % |
| Other income (expense), net | 29 | 0 % | (4) | 0 % | 40 | 0 % | 15 | 0 % |
| Income before income taxes | 1,421 | 12 % | 5,362 | 47 % | 3,267 | 10 % | 8,464 | 25 % |
| Provision for income taxes | 492 | 4 % | 1,987 | 17 % | 1,310 | 4 % | 2,956 | 9 % |
| Net income | \$929 | 8 % | \$3,375 | 29 % | \$1,957 | 6 % | \$5,508 | 16 % |

Revenue

Revenue for the three months ended September 30, 2012 ("2012 Q3") increased by approximately 1% over the three months ended September 30, 2011 ("2011 Q3"). The near flat revenue was due to reduced demand in Asia offset by increased demand in Europe. Increases in revenue from premium and personal product categories were offset by declines in revenue from professional products.

Revenue for the nine months ended September 30, 2012 ("2012 YTD") decreased by approximately 2% over the nine months ended September 30, 2011 ("2011 YTD"). The revenue decreased due to reduced demand across all the regions and all the product categories with the exception of premium and personal product categories.

The decline in revenue was partially offset by additional revenue from video conferencing and digital signage products.

During 2012 Q3 and 2011 Q3, the net change in deferred revenue was net deferral of revenue of \$94,000 and net recognition of revenue of \$49,000, respectively. During 2012 YTD and 2011 YTD, the net change in deferred revenue was net deferral of \$141,000 and net recognition of revenue of \$601,000, respectively. See "Critical Accounting Policies and Estimates" under "Revenue and Associated Allowance for Revenue Adjustments and Doubtful Accounts"

below for a detailed discussion of deferred revenue.

Costs of Goods Sold and Gross Profit

Costs of goods sold include expenses associated with finished goods purchased from electronic manufacturing services (EMS) providers, in addition to other operating expenses, which include material and direct labor, our manufacturing and operations organization, property and equipment depreciation, warranty expenses, freight expenses, royalty payments, and the allocation of overhead expenses.

Our gross profit margin (GPM), which is gross profit as a percentage of revenue, was 58% and 61% in 2012 Q3 and 2011 Q3, respectively. GPM for 2012 Q3 decreased due to unfavorable product mix and higher overhead absorption due to a substantial decrease in inventory of \$2.7 million. GPM for 2012 YTD did not change from the GPM of 60% for 2011 YTD.

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Operating Expenses

2012 Q3 operating expenses were approximately \$5.3 million, compared to the same amount in 2011 Q3 after excluding litigation proceeds from Biamp amounting to \$3.7 million. 2012 YTD operating expenses excluding litigation proceeds of \$250,000 were approximately \$16.9 million, an increase of approximately \$1.2 million from \$15.7 million in 2011 YTD after excluding litigation proceeds from Biamp amounting to \$3.7 million, or an increase of 8%. See Proceeds from litigation below for additional information on the litigation proceeds received in 2012 YTD and 2011 YTD from Biamp.

Sales and Marketing ("S&M") Expenses. S&M expenses include selling, customer service, and marketing expenses such as employee-related costs, allocations of overhead expenses, trade shows, and other advertising and selling expenses.

S&M expenses during 2012 Q3 decreased \$363,000 or 17% when compared to 2011 Q3 primarily due to decreases in commission and bonus payments to sales people and independent sales agents. S&M expenses during 2012 YTD remained at the same level as it was during YTD.

Research and Development ("R&D") Expenses. R&D expenses include research and development and product line management, including employee-related costs, outside services, expensed materials and depreciation, and an allocation of overhead expenses.

R&D expenses during 2012 Q3 increased by \$163,000, or 9%, compared to R&D expenses during 2011 Q3. The increase was primarily due to increases in employee-related costs due to recent acquisitions, partially offset by decreases in project related costs.

R&D expenses during 2012 YTD increased by \$747,000, or 14%, compared to R&D expenses during 2011 YTD. The increase was primarily due to increases in employee-related costs due to recent acquisitions, and other hires partially offset by decreases in software and subscription costs.

General and Administrative ("G&A") Expenses. G&A expenses include employee-related costs, professional service fees, allocations of overhead expenses, litigation costs, and corporate administrative costs, including finance, information technology and human resources.

G&A expenses during 2012 Q3 increased by \$212,000, or 16%, compared to expenses during 2011 Q3. The increase was primarily due to increased costs associated with the recently acquired operations of VCON, an increase in amortization of intangibles, and increased employee-related costs, partially offset by a reduction in bad debts.

G&A expenses during 2012 YTD increased by \$570,000, or 14%, compared to expenses during 2011 YTD. The increase was primarily due to increased costs associated with the recently acquired operations of VCON, an increase in amortization of intangibles and bank fees, partially offset by reduction in legal expenses, bad debts, recruitment costs and consulting expenses.

We continue to incur high legal expenses due to various litigation items explained in detail in our Form 10-K for the year ended December 31, 2011 and updated in our subsequent Form 10-Qs.

Proceeds from Litigation

The litigation proceeds received in 2012 YTD of \$250,000 represent the receipt of a settlement of amounts due from a defendant in our litigation related to the “Theft of Intellectual Property and Related Cases” described in detail in Note 8 – Commitments and Contingencies of the Notes to the Consolidated Financial Statements in our Form 10-K for the year ended December 31, 2011. Operating expenses for 2011 Q3 and 2011 YTD are reduced by a credit of \$3.7 million for proceeds receivable from Biamp with respect to a judgment award in litigation related to the theft of our intellectual property.

Other income (expense), net

Other income (expense), net, includes interest income, interest expense, and currency gain (loss).

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF
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Provision for income taxes

During 2012 Q3, we accrued income taxes at the expected annualized rate of 37.7% as compared to annualized rate of 33.5% in 2011 Q3. The increase in the expected annualized rate in 2012 Q3 was primarily due to the expiration of federal R&D credit on December 31, 2011.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2012, our cash and cash equivalents were approximately \$14.3 million, a decrease of \$2.4 million compared to cash and cash equivalents of approximately \$16.7 million as of December 31, 2011.

Net cash provided by operating activities was \$2.6 million in 2012 YTD, an increase of approximately \$590,000 compared to \$2.0 million cash provided by operating activities in 2011 YTD. The increase was primarily due to a decrease in inventories and an increase in accrued expenses offset by an increase in income taxes payable.

Net cash used in investing activities in 2012 YTD was approximately \$4.9 million, which consisted of the acquisition of the business of VCON for \$4.6 million and \$260,000 towards purchases of equipment. Net cash used in investing activities in 2011 YTD consisted of the acquisition of the business of MagicBox for \$750,000 and \$309,000 towards purchases of equipment.

Net cash used in financing activities in 2012 YTD was approximately \$83,000, which consisted of the acquisition of outstanding stock totaling \$384,000, offset by \$301,000 proceeds received on exercise of stock options. In 2011 YTD, net cash provided by financing activities amounted to \$732,000 through proceeds received on the exercise of stock options.

As of September 30, 2012 our working capital was \$30.9 million as compared to \$32.7 million as of December 31, 2011.

We believe that future income from operations and effective management of working capital will provide the liquidity needed for at least the next twelve months to meet our short-term and long-term operating requirements and finance our growth plans. We also believe that our strong financial position and solid business model will help us raise additional capital when needed to meet our short and long-term financing needs. In addition to capital expenditures, we may use cash in the near future for selective investments in technological, marketing or product manufacturing capabilities to broaden our product offerings, and for acquisitions that may strategically fit our business and are accretive to our business performance. However, no assurance can be given that changes will not occur that would consume available capital resources at a rate more rapidly than anticipated and we may need or want to raise additional capital through debt or equity financing to fund our long term operating requirements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our results of operations and financial position are based upon our consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles. We review the accounting policies used in reporting our financial results on a regular basis. The preparation of these

financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We evaluate our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluations. We believe that the estimates we use are reasonable; however, actual results could differ from those estimates.

Our significant accounting policies are described in Note 2 of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2011 and Note 1 to the Condensed Consolidated Financial Statements attached herewith. We believe the policies described below identify our most critical accounting policies, which are the policies that are both important to the representation of our financial condition and results and require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

Revenue and Associated Allowances for Revenue Adjustments and Doubtful Accounts

Included in continuing operations is product revenue, primarily from product sales to distributors, dealers, and end-users. Product revenue is recognized when (i) the products are shipped and any right of return expires, (ii) persuasive evidence of an

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

arrangement exists, (iii) the price is fixed and determinable, and (iv) collection is reasonably assured.

We provide a right of return on product sales to major distributors under a product rotation program. Under this seldom used program, a distributor is allowed to return, once a quarter, products purchased during the prior 180 days for a total value generally not exceeding 15% of the distributor's net purchases during the preceding quarter. The distributor is, however, required to place a new purchase order for an amount not less than the value of products returned under the stock rotation program. When products are returned, the associated revenue, cost of goods sold, inventory and accounts receivable originally recorded are reversed. When the new order is placed, the revenue, associated cost of goods sold, inventory and accounts receivable are recorded and the product revenue is subject to deferral analysis as described below. In a small number of cases, the distributors are also permitted to return the products for other business reasons.

Revenue from product sales to distributors is not recognized until the return privilege has expired or it can be determined with reasonable certainty that the return privilege has expired, which approximates when product is sold-through to customers of our distributors (dealers, system integrators, value-added resellers, and end-users) rather than when the product is initially shipped to a distributor. We evaluate, at each quarter-end, the inventory in the channel through information provided by our distributors. The level of inventory in the channel will fluctuate up or down, each quarter, based upon our distributors' individual operations. Accordingly, each quarter-end deferral of revenue and associated cost of goods sold is calculated and recorded based upon the actual channel inventory reported at quarter-end. Further, with respect to distributors and other channel partners not reporting channel inventory, the revenue and associated cost of goods sold are deferred until we receive payment for the product sales made to such distributors or channel partners.

The accuracy of the deferred revenue and costs depends to a large extent on the accuracy of the inventory reports provided by our distributors and other resellers and any material error in those reports would affect our revenue deferral. However, we believe that the controls we have in place, including periodic physical inventory verifications and analytical reviews, would help us identify and prevent any material errors in such reports.

The amount of deferred cost of goods sold was included in consigned inventory. The following table details the amount of deferred revenue, cost of goods sold, and gross profit (dollars in thousands):

| | September 30, 2012 | December 31, 2011 |
|-----------------------------|--------------------|-------------------|
| Deferred revenue | \$3,545 | \$3,404 |
| Deferred cost of goods sold | 1,270 | 1,199 |
| Deferred gross profit | \$2,275 | \$2,205 |

We offer rebates and market development funds to certain of our distributors, dealers/resellers, and end-users based upon volume of product purchased by them. We record rebates as a reduction of revenue in accordance with GAAP.

We offer credit terms on the sale of our products to a majority of our customers and perform ongoing credit evaluations of our customers' financial condition. We maintain an allowance for doubtful accounts for estimated losses resulting from the inability or unwillingness of our customers to make required payments based upon our historical collection experience and expected collectability of all accounts receivable. Our actual bad debts in future periods may differ from our current estimates and the differences may be material, which may have an adverse impact on our future accounts receivable and cash position.

Impairment of Goodwill and Intangible Assets

We allocated the purchase price of our acquisition of NetStreams, Inc. and the business of Magic Box, Inc. on the basis of well-established valuation techniques performed by qualified experts. The purchase price towards the acquisition of the business of VCON Video Conferencing, Ltd. has been allocated on a provisional basis pending full valuation. Goodwill is measured as the excess of the fair value of acquisition consideration over the sum of the fair values of tangible and identifiable intangible assets acquired less liabilities assumed. We intend to perform impairment tests of goodwill and intangible assets with an indefinite useful life, on an annual basis in the fourth fiscal quarter, or sooner if a triggering event occurs suggesting possible impairment of the values of these assets. As of September 30, 2012, \$1.9 million and \$759,000 have been recorded as goodwill and intangible assets with an indefinite useful life, respectively. In response to changes in industry, technology and competitive circumstances, we may be required to exit or dispose of the acquired businesses, which could result in an impairment of goodwill and intangible assets.

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Impairment of Long-Lived Assets

We assess the impairment of long-lived assets, such as property and equipment and definite-lived intangibles subject to amortization, annually or whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset or asset group to estimated future undiscounted net cash flows of the related asset or group of assets over their remaining lives. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment charge is recognized for the amount by which the carrying amount exceeds the estimated fair value of the asset. Impairment of long-lived assets is assessed at the lowest levels for which there are identifiable cash flows that are independent of other groups of assets. The impairment of long-lived assets requires judgments and estimates. If circumstances change, such estimates could also change. Assets held for sale are reported at the lower of the carrying amount or fair value, less the estimated costs to sell.

Accounting for Income Taxes

We are subject to income taxes in both the United States and in certain non-U.S. jurisdictions. We estimate our current tax position together with our future tax consequences attributable to temporary differences resulting from differing treatment of items, such as deferred revenue, depreciation, and other reserves for tax and accounting purposes. These temporary differences result in deferred tax assets and liabilities. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, prior year carryback, or future reversals of existing taxable temporary differences. To the extent we believe that recovery is not more likely than not, we establish a valuation allowance against these deferred tax assets. Significant judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our deferred tax assets. To the extent we establish a valuation allowance in a period, we must include and expense the allowance within the tax provision in the consolidated statement of operations. Our valuation allowance at September 30, 2012 is \$1.1 million.

Lower-of-Cost or Market Adjustments and Reserves for Excess and Obsolete Inventory

We account for our inventory on a first-in, first-out basis, and make appropriate adjustments on a quarterly basis to write-down the value of inventory to the lower-of-cost or market. In addition to the price of the product purchased, the cost of inventory includes our internal manufacturing costs including warehousing, material purchasing, quality and product planning expenses.

We perform a quarterly analysis of obsolete and slow-moving inventory to determine if any inventory needs to be written down. In general, we write down our excess and obsolete inventory by an amount that is equal to the difference between the cost of the inventory and its estimated market value if market value is less than cost, based upon assumptions about future product life-cycles, product demand, shelf life of the product, inter-changeability of the product and market conditions. Those items that are found to have a supply in excess of our estimated current demand are considered to be slow-moving or obsolete and classified as long-term. An appropriate reserve is made to write down the value of that inventory to its expected realizable value. These charges are recorded in cost of goods sold. The reserve against slow-moving or obsolete inventory is established based on several factors which, among other things, require us to make an estimate of a product's life-cycle, potential demand and our ability to sell these products at estimated price levels. While we make considerable efforts to calculate reasonable estimates of these variables, actual results may vary. If there were to be a sudden and significant decrease in demand for our products, or if there were a higher incidence of inventory obsolescence because of changing technology and customer requirements, we could be required to increase our inventory reserves, and our gross profit could be adversely affected.

Share-Based Compensation

Prior to June 30, 2005 and as permitted under the then existing FASB guidelines under SFAS No. 123, "Accounting for Stock-Based Compensation," we accounted for our share-based payments following the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," as interpreted. Accordingly, no share-based compensation expense had been reflected in our statements of operations for unmodified option grants since (1) the exercise price equaled the market value of the underlying common stock on the grant date and (2) the related number of shares to be granted upon exercise of the stock option was fixed on the grant date.

In December 2004, the FASB issued guidelines now contained under FASB ASC Topic 718, Compensation – Stock Compensation. ASC Topic 718 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. Primarily, this Topic focuses on accounting for transactions in which an entity obtains employee services in share-based payment transactions. It also addresses transactions in which an entity incurs liabilities in

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exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Under ASC Topic 718, we measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the awards – the requisite service period (usually the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service. Therefore, if an employee does not ultimately render the requisite service, the costs associated with the unvested options will not be recognized cumulatively.

Effective July 1, 2005, we adopted the guidelines contained in ASC Topic 718 and its fair value recognition provisions using the modified prospective transition method. Under this transition method, stock-based compensation cost recognized after July 1, 2005 includes the straight-line basis compensation cost for (a) all share-based payments granted prior to July 1, 2005, but not yet vested, based on the grant date fair values used for the pro-forma disclosures under the original SFAS No. 123 and (b) all share-based payments granted or modified on or after July 1, 2005, in accordance with the provisions of ASC Topic 718.

Under ASC Topic 718, we recognize compensation cost net of an anticipated forfeiture rate and recognize the associated compensation cost for those awards expected to vest on a straight-line basis over the requisite service period. We use judgment in determining the fair value of the share-based payments on the date of grant using an option-pricing model with assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the risk-free interest rate of the awards, the expected life of the awards, the expected volatility over the term of the awards, the expected dividends of the awards, and an estimate of the amount of awards that are expected to be forfeited. If assumptions change in the application of ASC Topic 718 and its fair value recognition provisions in future periods, the stock-based compensation cost ultimately recorded under the guidelines of ASC Topic 718 may differ significantly from what was recorded in the current period.

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CLEARONE COMMUNICATIONS, INC.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

Item 4. CONTROLS AND PROCEDURES

An evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of September 30, 2012 was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based on this evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures are effective as of September 30, 2012 to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported as specified in the SEC's rules and forms.

There was no change in our internal control over financial reporting during the quarter ended September 30, 2012 that materially affected, or that we believe is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The following is an update to the status of the legal proceedings and commitments and contingencies reported in our Form 10-K for the year ended December 31, 2011 under Part I, Item 3. Legal Proceedings and Note 8 - Commitments and Contingencies of the Notes to Consolidated Financial Statements (Part II, Item 8) and our subsequent Form 10-Qs under Part II, Item 1. Legal Proceedings.

Former Officer Indemnification:

Flood: As previously reported, on April 4, 2011, the Tenth Circuit Court of Appeals in Denver affirmed Frances Flood's conviction, but has allowed her to assert in a collateral proceeding her claim that she received ineffective assistance of counsel because her trial counsel allegedly labored under actual conflicts of interest. On June 5, 2012, Judge Benson denied Flood's motion to vacate and set aside her conviction based on this theory, but Ms. Flood has appealed this ruling to the Tenth Circuit.

On August 15, 2012 we filed a motion for summary judgment in the Federal District Court for the District of Utah with respect to our counterclaim for approximately \$2,948,000 seeking to enforce Flood's August 2003 promise to repay all advanced expenses if it was ultimately adjudged that she did not meet the requisite standard of conduct. Our motion also seeks summary judgment with respect to Ms. Flood's remaining claims. Flood's counsel has withdrawn from representing her and she, currently acting as pro se, is seeking additional time to respond to the motion.

Strohm: As previously reported, on June 8, 2011, the Third Judicial District Court in Salt Lake City, Utah, entered Judgment in Susie Strohm's lawsuit against us for \$973,000 in fees and expenses in the criminal case, plus \$362,000 in interest at 18% through February 1, 2011, which amounts were paid by us under protest to her counsel, Dorsey, on February 1, 2011. The Judgment also included \$865,000 in civil case fees and expenses plus interest. We have posted a cash bond to cover the civil case fees and interest pending our appeal. On August 4, 2011, the Utah Supreme Court decided that it would hear our appeal.

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Susie Strohm’s counsel appealed as well. Appellate briefs were fully submitted on March 22, 2012. On September 6, 2012, the Utah Supreme Court heard oral argument on our appeal and Dorsey's cross-appeal and we are awaiting the Court's decision.

Theft of Intellectual Property and Related Cases:

As previously reported, in December 2011, we reached a settlement with Biamp, resulting in payment to us of \$3,860,000, including by release of sum of \$3,702,000 to us from the supersedeas bonds posted by Biamp with the Third Judicial District Court, Salt Lake County, State of Utah, and an additional payment. In February 2012, we reached a settlement with a Wideband defendant resulting in payment to us of \$250,000.

In August 2007, we filed a motion for a preliminary injunction in the United States District Court, District of Utah, seeking to enjoin Wideband Solutions, Inc. from licensing certain technology we believe constituted our intellectual property and trade secrets to Harman Music Group, Inc. (“Harman”). On September 13, 2007, the court in the Trade Secret Case granted ClearOne leave to add Harman and a former ClearOne employee working for Harman as defendants in that case. For procedural reasons, these claims against Harman and the Harman employee were refiled in Utah state court, the Third Judicial District Court for Salt Lake County, on September 18, 2007 (the “Harman Case”).

Like the Intellectual Property Case, the Harman Case brought claims related to the theft and misuse of ClearOne’s confidential and trade secret information. Harman asserted a counterclaim for bad-faith initiation of litigation.

In August 2012, this case was settled pursuant to a Confidential Settlement Agreement that resolved the case to the satisfaction of all parties.

Donald Bowers filed appeals in January and February 2012 challenging \$236,000 of the \$294,000 in the attorney fees awarded against him.

The DialHD Georgia Action:

On July 27, 2012, the Superior Court of Columbia County in the State of Georgia awarded sanctions against Donald Bowers, and requested we submit a calculation of our fees and costs. On August 3, 2012, we submitted our calculation, requesting \$81,000 in costs and attorney fees. The Court has not ruled on this request.

ARS Special Arbitration:

The second and final session of the arbitration against Morgan Stanley was completed on October 8, 2012. Arbitration sessions against UBS was completed on November 2, 2012.

Item 1A. RISK FACTORS

Not applicable.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchases of Equity Securities

The table below summarizes information about our purchases of our equity securities registered pursuant to Section 12 of the Exchange Act of 1934, as amended, during the quarterly period ended September 30, 2012.

| Period | Total Number of Shares Purchased (1) | Average Price Paid Per Share (2) | Total Number of Shares Purchased as | Maximum Approximate Dollar Value of |
|--------|--------------------------------------|----------------------------------|-------------------------------------|-------------------------------------|
|--------|--------------------------------------|----------------------------------|-------------------------------------|-------------------------------------|

| | | | Part of Publicly Announced Plans or Programs (1) | Shares that May Yet Be Purchased under the Plans or Program (in millions) |
|---|--------|--------|---|---|
| July 1, 2012 through July 31, 2012 | — | \$— | — | \$— |
| August 1, 2012 through August 31, 2012 | 12,946 | \$4.12 | 35,760 | \$2,854,652 |
| September 1, 2012 through September 30, 2012 | 58,984 | \$4.05 | 58,984 | \$2,615,628 |
| Total | 71,930 | \$4.06 | 94,744 | |

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CLEARONE COMMUNICATIONS, INC.

In May 2012, our Board of Directors authorized a stock repurchase program. Under the program, we are authorized to repurchase up to \$2 million of our outstanding common stock from time to time over the following 12 months. Any stock repurchases may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate, including pursuant to one or more Rule 10b5-1 trading plans. Rule 10b5-1 permits us to establish, while not in possession of material nonpublic information, (1) prearranged plans to buy stock at a specific price in the future, regardless of any subsequent possession of material nonpublic information. The timing and actual number of shares repurchased will depend on a variety of factors, including market conditions and other factors. The stock repurchase program may be suspended or discontinued at any time without prior notice. On July 30, 2012, the Board of Directors increased the repurchase amount to \$3 million from the original \$2 million.

(2) The price paid per share of common stock includes the related transaction costs.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

Not applicable.

Item 6. EXHIBITS

| Exhibit No. | Title of Document |
|-------------|--|
| 31.1 | Section 302 Certification of Chief Executive Officer |
| 31.2 | Section 302 Certification of Principal Financial Officer |
| 32.1 | Section 906 Certification of Chief Executive Officer |
| 32.2 | Section 906 Certification of Principal Financial Officer |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definitions Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

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CLEARONE COMMUNICATIONS, INC.

SIGNATURES

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

ClearOne Communications, Inc.,
(Registrant)

November 14, 2012

By: /s/ Zeynep Hakimoglu
Zeynep Hakimoglu
Chief Executive Officer
(Principal Executive Officer)

November 14, 2012

By: /s/ Narsi Narayanan
Narsi Narayanan
Vice President of Finance
(Principal Financial and Accounting Officer)