Digimarc CORP
Form 10-K/A
August 07, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Amendment No. 1)

(Mark One)

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the fiscal year ended December 31, 2012

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)

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

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

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

The aggregate market value of common stock, par value $0.001 per share, held by non-affiliates of the registrant, based on the closing price of our common stock on The Nasdaq Global Market on the last business day of the registrant s most recently completed fiscal second quarter (June 29, 2012), was approximately $174 million. Shares of common stock beneficially held by each officer and director have been excluded from this computation because these persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purposes.

As of February 15, 2013, 7,281,983 shares of the registrant s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s proxy statement pursuant to Regulation 14A for its 2013 annual meeting of shareholders are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K.

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EXPLANATORY NOTE

Digimarc Corporation is filing this Amendment No. 1 (Amendment No. 1) to our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (the Form 10-K) in response to comments received from the Staff of the Securities and Exchange Commission regarding (i) the Form 10-K, and (ii) a request for confidential treatment of certain portions of Exhibit 10.2 originally filed with the Form 10-K. We are filing this Amendment No. 1 solely to re-file Exhibit 10.2, re-file Exhibit 23.1 and amend and restate Part II Item 8 and Part IV Item 15 included in the Form 10-K. In addition, as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, we are filing new certifications by the Company s principal executive officer and principal financial officer as exhibits to this Amendment No. 1.

Except as described above, no other amendments or updates have been made to the Form 10-K as originally filed. This Amendment No. 1 does not reflect events after the original filing of the Form 10-K and does not modify or update any disclosures in the Form 10-K that may have been affected by subsequent events.

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PART II

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our Consolidated Financial Statements and the accompanying Notes that are filed as part of this Annual Report are listed under Part IV, Item 15, Exhibits and Financial Statement Schedules and are set forth beginning on page F-1 immediately following the signature page of this Form 10-K/A.

PART IV

ITEM 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements

The following documents are filed as part of this Annual Report on Form 10-K:

(i) Report of Independent Registered Public Accounting Firm KPMG LLP

(ii) Consolidated Balance Sheets as of December 31, 2012 and 2011

(iii) Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010

(iv) Consolidated Statements of Shareholders Equity for the years ended December 31, 2012, 2011 and 2010

(v) Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010

(vi) Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules

All schedules have been omitted since they are not required or are not applicable or the required information is shown in the consolidated financial statements or related notes.

(a)(3) Exhibits

See the Exhibit Index at page E-1 of this Annual Report on Form 10-K.

(b) Exhibits

See the Exhibit Index at page E-1 of this Annual Report on Form 10-K.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	DIGIMARC CORPORATION
Date: August 7, 2013	By: /s/ Michael McConnell **Michael McConnell**
	Title: Chief Financial Officer

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DIGIMARC CORPORATION INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Digimarc Corporation:

We have audited the accompanying consolidated balance sheets of Digimarc Corporation and subsidiary as of December 31, 2012 and 2011 and the related consolidated statements of operations, shareholders equity, and cash flows for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Digimarc Corporation and subsidiary as of December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Digimarc Corporation s internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 22, 2013 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

Portland, Oregon

February 22, 2013

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DIGIMARC CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

	December 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,866	$ 3,419
Marketable securities	25,403	22,244
Trade accounts receivable, net	4,216	3,502
Other current assets	1,016	1,306
Total current assets	37,501	30,471
Marketable securities	6,787	7,715
Property and equipment, net	1,453	1,395
Intangibles, net	6,721	2,808
Goodwill	1,114	
Investments in joint ventures		415
Deferred tax assets, net	3,589	2,634
Other assets	166	355
Total assets	$ 57,331	$ 45,793
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 1,143	$ 952
Deferred revenue	2,512	2,660
Total current liabilities	3,655	3,612
Deferred rent and other long-term liabilities	673	464
Total liabilities	4,328	4,076
Commitments and contingencies (Note 16)		
Shareholders equity:		
Preferred stock (par value $0.001 per share, 2,500,000 authorized, 10,000 shares issued and outstanding at December 31, 2012 and 2011)	50	50
Common stock (par value $0.001 per share, 50,000,000 authorized, 7,168,359 and 7,008,031 shares issued and outstanding at December 31, 2012 and 2011, respectively)	7	7
Additional paid-in capital	39,869	34,511
Retained earnings	13,077	7,149
Total shareholders equity	53,003	41,717
Total liabilities and shareholders equity	$ 57,331	$ 45,793

See Notes to Consolidated Financial Statements.

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DIGIMARC CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Revenue:			
Service	$ 10,792	$ 12,395	$ 12,324
License and subscription	33,583	23,644	18,826
Total revenue	44,375	36,039	31,150
Cost of revenue:			
Service	5,917	6,638	6,464
License and subscription	591	299	236
Total cost of revenue	6,508	6,937	6,700
Gross profit	37,867	29,102	24,450
Operating expenses:			
Sales and marketing	3,827	4,336	3,545
Research, development and engineering	8,741	7,327	5,687
General and administrative	9,457	9,956	7,864
Intellectual property	1,248	1,094	1,203
Total operating expenses	23,273	22,713	18,299
Operating income	14,594	6,389	6,151
Net loss from joint ventures	(1,107)	(2,714)	(2,180)
Interest income, net	179	195	245
Income before income taxes	13,666	3,870	4,216
(Provision) benefit for income taxes	(5,394)	1,786	(42)
Net income	$ 8,272	$ 5,656	$ 4,174
Earnings per common share:			
Net income per common share basic	$ 1.16	$ 0.84	$ 0.59
Net income per common share diluted	$ 1.12	$ 0.76	$ 0.55
Weighted average common shares outstanding basic	6,757	6,741	7,120
Weighted average common shares outstanding diluted	6,989	7,430	7,623
Cash dividends declared per common share	$ 0.33	$	$

See Notes to Consolidated Financial Statements.

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DIGIMARC CORPORATION

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(In thousands, except share data)

	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, 2009	10,000	$ 50	7,205,701	$ 7	$ 49,283	$ (2,681)	$ 46,659
Exercise of stock options			313,832		3,045		3,045
Issuance of restricted common stock			124,560				
Forfeiture of restricted common stock			(3,450)				
Purchase and retirement of common stock			(197,193)		(5,824)		(5,824)
Stock-based compensation					3,105		3,105
Net loss						4,174	4,174
BALANCE AT DECEMBER 31, 2010	10,000	50	7,443,450	7	49,609	1,493	51,159
Exercise of stock options			169,420		1,651		1,651
Issuance of restricted common stock			190,180				
Forfeiture of restricted common stock			(18,120)				
Purchase and retirement of common stock			(776,899)		(22,048)		(22,048)
Stock-based compensation					4,231		4,231
Tax benefit from stock-based awards					1,068		1,068
Net income						5,656	5,656
BALANCE AT DECEMBER 31, 2011	10,000	50	7,008,031	7	34,511	7,149	41,717
Exercise of stock options			172,250		1,660		1,660
Issuance of restricted common stock			202,340				
Forfeiture of restricted common stock			(12,300)				
Purchase and retirement of common stock			(201,962)		(4,760)		(4,760)
Stock-based compensation					5,414		5,414
Tax benefit from stock-based awards					3,044		3,044
Net income						8,272	8,272
Cash dividends declared						(2,344)	(2,344)
BALANCE AT DECEMBER 31, 2012	10,000	$ 50	7,168,359	$ 7	$ 39,869	$ 13,077	$ 53,003

See Notes to Consolidated Financial Statements.

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DIGIMARC CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Cash flows from operating activities:			
Net income	$ 8,272	$ 5,656	$ 4,174
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization of property and equipment	600	613	565
Amortization and write-off of intangibles	385	143	79
Stock-based compensation	5,256	4,216	3,068
Net loss from joint ventures	1,107	2,714	2,180
Deferred income taxes	(284)	(3,640)	
Tax benefit from stock-based awards	3,688	1,873	
Excess tax benefit from stock-based awards	(3,044)	(1,068)	
Changes in operating assets and liabilities:			
Trade accounts receivable, net	(187)	(21)	89
Other current assets	219	240	(473)
Other assets	201	107	(32)
Accounts payable and other liabilities	(228)	(668)	507
Deferred revenue	(384)	88	275
Net cash provided by operating activities	15,601	10,253	10,432
Cash flows from investing activities:			
Purchase of property and equipment	(570)	(678)	(781)
Capitalized patent costs and purchased intellectual property	(1,170)	(712)	(914)
Investments in joint ventures, net	(692)	(2,100)	(2,800)
Business acquisitions, net of cash acquired	(5,092)		
Sale or maturity of marketable securities	144,214	74,689	122,176
Purchase of marketable securities	(146,444)	(65,044)	(127,878)
Net cash provided by (used in) investing activities	(9,754)	6,155	(10,197)
Cash flows from financing activities:			
Issuance of common stock	1,660	1,651	3,045
Purchase of common stock	(4,760)	(22,048)	(5,824)
Cash dividends paid	(2,344)		
Excess tax benefit from stock-based awards	3,044	1,068	
Net cash used in financing activities	(2,400)	(19,329)	(2,779)
Net increase (decrease) in cash and cash equivalents	3,447	(2,921)	(2,544)
Cash and cash equivalents at beginning of period	3,419	6,340	8,884
Cash and cash equivalents at end of period	$ 6,866	$ 3,419	$ 6,340
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	$ 1,819	$ 13	$ 42
Supplemental schedule of non-cash investing activities:			
Stock-based compensation capitalized to patent costs	$ 108	$ 65	$ 37
Supplemental schedule of non-cash financing activities:			

Exercise of stock options	$	1,660	$	1,651	$	3,038

See Notes to Consolidated Financial Statements.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(1) Description of Business and Summary of 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 s inventions provide the means to infuse persistent digital information, perceptible only to computers and digital devices, into all forms of media content. 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.

Principles of Consolidation

The consolidated financial statements include the accounts of Digimarc and its wholly-owned subsidiary. All intercompany transactions and balances have been eliminated.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. requires Digimarc to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Certain of the Company s accounting policies require higher degrees of judgment than others in their application. These include revenue recognition on long-term license and service contracts, goodwill, impairments and estimation of useful lives of long-lived assets, contingencies and litigation, patent costs, stock-based compensation and income taxes. Digimarc bases its estimates on historical experience and on various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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.

Cash Equivalents

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, certificates of deposit, commercial paper, and pre-refunded municipal bonds totaling $5,878 and $2,992 at December 31, 2012 and 2011, respectively. Cash equivalents are carried at cost or amortized cost, which approximates market.

Marketable Securities

The Company considers all investments with original maturities over 90 days that mature in less than one year from the balance sheet date to be short-term marketable securities. Both short- and long-term marketable securities primarily include U.S. federal agency notes, U.S. treasuries, corporate notes, pre-refunded municipal bonds, and commercial paper. The Company s marketable securities are classified as held-to-maturity and are reported at amortized cost, which approximates market.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

A decline in the market value of any security below amortized cost that is deemed to be other-than-temporary results in a reduction in the carrying amount. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating that the cost of the investment is recoverable outweighs evidence to the contrary. There have been no other-than-temporary impairments identified or recorded by the Company.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using a method that approximates the effective interest method. Under this method, dividend and interest income are recognized when earned.

Fair Value of Financial Instruments

Accounting Standards Certification (ASC) 820 *Fair Value Measurements and Disclosures* defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles in the U.S., and enhances disclosures about fair value measurements. ASC 820 describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

Level 1 Pricing inputs are quoted prices available in active markets for identical investments as of the reporting date.

Level 2 Pricing inputs are quoted for similar investments, or inputs that are observable, either directly or indirectly, for substantially the full term through corroboration with observable market data. Level 2 includes investments valued at quoted prices adjusted for legal or contractual restrictions specific to these investments.

Level 3 Pricing inputs are unobservable for the investment; that is, the inputs reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability.

The estimated fair values of the Company s financial instruments, which include cash and 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.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

The Company s fair value hierarchy for its cash equivalents and marketable securities as of December 31, 2012 and 2011, respectively, was as follows:

December 31, 2012	Level 1	Level 2	Level 3	Total
Money market securities	$ 901	$	$	$ 901
Certificates of deposits		491		491
U.S. treasuries		289		289
U.S. federal agency notes		1,637		1,637
Pre-refunded and other municipals		22,036		22,036
Corporate notes		10,100		10,100
Commercial paper		2,614		2,614
Total	$ 901	$ 37,167	$	$ 38,068

December 31, 2011	Level 1	Level 2	Level 3	Total
Money market securities	$ 896	$	$	$ 896
Certificates of deposits		736		736
U.S. treasuries		718		718
U.S. federal agency notes		7,942		7,942
Pre-refunded and other municipals		2,800		2,800
Corporate notes		16,459		16,459
Commercial paper		3,400		3,400
Total	$ 896	$ 32,055	$	$ 32,951

The fair value maturities of the Company s cash equivalents and marketable securities as of December 31, 2012 are as follows:

		Maturities by Period			
	Total	Less than 1 year	1-5 years	5-10 years	More than 10 years
Maturities	$ 38,068	$ 31,200	$ 6,868	$	$

Concentrations of Business and Credit Risk

A significant portion of the Company s business depends on a limited number of large contracts. The loss of any large contract may result in loss of revenue and margin on a prospective basis. Financial instruments that potentially subject Digimarc to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities, and trade accounts receivable. Digimarc places its cash and cash equivalents with major banks and financial institutions and at times deposits may exceed insured limits. Other than cash used for operating needs, which may include short-term marketable securities with the Company s principal banks, Digimarc s investment policy limits its credit exposure to any one financial institution or type of financial instrument by limiting the maximum of 5% of its cash equivalents and marketable securities or $1,000, whichever is greater, to be invested in any one issuer except for the U.S. government, U.S. federal agencies and U.S. backed securities, which have no limits, at the time of purchase. The Company s investment policy also limits its credit exposure by limiting the maximum of 40% of its cash and cash equivalents and marketable securities, or $15,000, whichever is greater, to be invested in any one industry category, (e.g., financial or energy industries), at the time of purchase. As a result, Digimarc s credit risk associated with cash and cash equivalents and marketable securities is believed to be minimal.

DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

Equity Method Investments

The Company accounts for its joint ventures under the equity method of accounting pursuant to ASC 323 *Investments Equity Method and Joint Ventures*. Under the equity method, investments are carried at cost, plus or minus the Company s proportionate share, based on present ownership interests, of: (*a*) the investee s profit or loss after the date of acquisition; (*b*) changes in the Company s equity that have not been recognized in the investee s profit or loss; and (*c*) certain other adjustments. Distributions received from the investee (such as dividends) reduce the carrying amount of the investment.

Goodwill

The Company accounts for business combinations under the acquisition method of account in accordance with ASC 805, *Business Combinations*, where the total purchase price is allocated to the tangible and identified intangible assets acquired and liabilities assumed based on their estimated fair values. The purchase price is allocated using the information currently available, and may be adjusted, up to one year from acquisition date, after obtaining more information regarding, among other things, asset valuations, liabilities assumed and revisions to preliminary estimates.

Contingent consideration is recorded at the acquisition date based upon the estimated fair value of the contingent payments. The fair value of the contingent consideration is re-measured each reporting period with any adjustments in fair value being recognized in earnings from operations.

The purchase price in excess of the fair value of the tangible and identified intangible assets acquired less liabilities assumed is recognized as goodwill.

The Company reviews goodwill in June of each year, or on an interim basis if required, for impairment to determine if events or changes in business conditions indicate that the carrying value of the goodwill may not be recoverable. Such reviews assess the fair value of the assets compared to the carrying values.

Impairment of Long-Lived Assets

The Company accounts for long-lived assets in accordance with the provisions of ASC 360 *Property, Plant and Equipment.* This statement requires that long-lived assets, including definite-lived intangible assets, be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount 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 to future net undiscounted cash flows expected to be generated by the asset over its remaining useful life. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value is determined based on discounted cash flows or appraised values, depending on the nature of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Through December 31, 2012, there have been no such impairment losses.

Research and Development

Research and development costs are expensed as incurred in accordance with ASC 730 *Research and Development.*

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS   (Continued)

(In thousands, except share and per share data)

Software Development Costs

Under ASC 985   *Software,*   software development costs are to be capitalized beginning when a product s technological feasibility has been established and ending when a product is made available for general release to customers. To date, the establishment of technological feasibility of the Company s products has occurred shortly before general release and, therefore, software development costs qualifying for capitalization have been immaterial. Accordingly, the Company has not capitalized any software development costs and has charged all such costs to research and development expense.

Patent Costs

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 award date, which varies depending on the pendency period of the application, generally approximating seventeen years. Capitalized patent costs, also referred to as patent prosecution costs, include internal legal labor, professional legal fees, government filing fees and translation fees related to obtaining the Company s patent portfolio.

Costs associated with the maintenance and annuity fees of patents are accounted for as prepaid assets at the time of payment and amortized over the shorter of the maintenance period or remaining life of the related patent.

Revenue Recognition

See Note 3 for detail disclosures of the Company s revenue recognition policy.

Stock-Based Compensation

ASC 718   *Compensation   Stock Compensation*   requires the measurement and recognition of compensation for all stock-based awards made to employees and directors including stock options and restricted stock based on estimated fair values.

For stock option awards the Company uses the Black-Scholes option pricing model as its method of valuation. The Company s determination of the fair value on the date of grant is affected by its stock price as well as assumptions regarding a number of highly subjective variables. These variables include, but are not limited to, the expected life of the award, the Company s expected stock price volatility over the term of the award, the risk-free interest rate and the expected dividend yield. Although the fair value of stock-based awards is determined in accordance with ASC 718 and SAB No. 107   *Shared-Based Payment*,   the Black-Scholes option pricing model requires the input of highly subjective assumptions, and other reasonable assumptions could provide differing results.

Income Taxes

The Company accounts for income taxes under the asset and liability method. Under the asset and liability method, deferred income taxes reflect the future tax consequences of differences between the tax basis of assets and liabilities and their financial reporting amounts. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not expected to be realized.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

The Company is subject to federal and state income taxes within the U.S. and in the ordinary course of business, there are transactions and calculations where the ultimate tax determination is uncertain. The Company is also subject to withholding taxes in various foreign jurisdictions. The withholding taxes are computed by the customers and paid to foreign jurisdictions on our behalf. The Company reports a liability (or contra asset) for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. The Company recognizes interest and penalties, if any, related to the unrecognized tax benefits in income tax expense.

(2) Recent Accounting Pronouncements

In July 2012, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2012-02, *Intangibles Goodwill and Other: Testing Indefinite-Lived Intangible Assets for Impairment*, to allow entities to use a qualitative approach to test indefinite-lived intangible assets for impairment. ASU 2012-02 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed quantitative impairment test by comparing the fair value of the indefinite-lived intangible asset with its carrying value. Otherwise, the quantitative impairment test is not required. ASU No. 2012-2 is effective for impairment tests for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The Company has adopted the provisions of this standard and noted no material impact on the financial condition or results of operations of the Company.

(3) Revenue Recognition

The Company derives its revenue primarily from development services and licensing of its patent portfolio:

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

License revenue, including royalty revenue, originates primarily from licensing the Company s technology and patents where the Company receives royalties as its income stream. Subscription revenue, which consists of products and services, are more recurring in nature.

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.

Some customer arrangements encompass multiple deliverables, such as patent license, professional services, software subscriptions, and maintenance 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 consideration for the arrangement is allocated to the separate units of accounting using the relative selling price method.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

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:

Revenue from professional service arrangements 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.

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 increase the likelihood the Company will grant a customer a concession, such as reduced license payments or additional rights, rather than hold firm on minimum commitments in an agreement to the point of losing a potential advocate and licensee of patented technology in the marketplace. 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.

Subscription revenue, which includes subscriptions for products and services, is generally paid in advance and s recognized over the term of the license or service period, which is generally one month to twenty-four months.

Deferred revenue consists of billings in advance for professional services, licenses and subscriptions for which revenue has not been earned.

(4) ***Acquisition of Attributor Corporation***

On December 3, 2012, Digimarc acquired Attributor pursuant to an Agreement and Plan of Merger (the Merger Agreement) by and among Digimarc, DA Sub Inc., a wholly owned subsidiary of Digimarc (Merger Sub), Attributor, and Fortis Advisors LLC, as the representative for Attributor s security holders. In accordance with the terms of the Merger Agreement, Merger Sub merged with and into Attributor (the Merger), with Attributor surviving the Merger as a wholly owned subsidiary of Digimarc.

Under the terms of the Merger Agreement, the closing merger consideration to be paid was $5,632 in cash less certain adjustments. The amount of cash paid by Digimarc after adjustments was $5,442. Additionally, $150 of the closing merger consideration was placed into an escrow account and subject to indemnification claims for a period up to 17 months. The Attributor stockholders may also receive up to an additional $900 of cash consideration that is contingent upon meeting certain performance objectives for the fiscal years ending December 31, 2012 and

2013, as set forth in the Merger Agreement. The contingent cash payment, if earned, will be made in March 2014. In addition, certain key employees of Attributor received $1,000 of restricted shares of common stock of Digimarc, issued pursuant to Digimarc s 2008 Incentive Plan, which vest over a two-year period and are contingent upon continued employment.

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(In thousands, except share and per share data)

The total purchase price is as follows:

Closing merger consideration	$ 5,442
Fair value of contingent consideration	190
Total purchase price	$ 5,632

The estimated fair value of the contingent consideration of $190 at December 31, 2012 is included in other long-term liabilities on the Consolidated Balance Sheet.

The Company incurred $0.2 million of transaction related expenses associated with the Attributor acquisition during the year ended December 31, 2012, which are reflected in general and administrative expense in the Consolidated Statements of Operations.

Preliminary Purchase Price Allocation

The Company accounted for the transaction using the acquisition method. Under the acquisition method of accounting, total purchase price as shown in the table above is allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. The purchase price was allocated using the information currently available, and Digimarc may adjust the preliminary purchase price allocation after obtaining more information. The final purchase price allocation is pending the completion of our review of the acquired tax assets and liabilities, which is expected to be completed by mid-2013.

The purchase price in excess of the fair value of the tangible and identified intangible assets acquired less liabilities assumed is recognized as goodwill. The preliminary allocation of the purchase price estimated at the December 3, 2012 acquisition date is as follows:

Total purchase price		$ 5,632
Less: Estimated fair value of net tangible assets acquired and (liabilities assumed):		
Cash and cash equivalents	$ 350	
Trade accounts receivable, net	527	
Other current assets	18	
Property and equipment, net	102	
Deferred tax assets	1,225	
Accounts payable and other accrued liabilities	(499)	
Deferred revenue	(225)	
Less: Estimated fair value of identifiable intangible assets acquired:		
Existing technology	1,560	
Customer relationships	290	
Backlog	760	
Tradenames	290	
Non-solicitation agreements	120	
Preliminary goodwill		$ 1,114

The goodwill is not deductible for tax purposes. Key factors that make up the goodwill created by the transaction include knowledge and experience of the acquired workforce and infrastructure and expected synergies from the combination of operations.

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Fair Value of Intangible Assets Acquired

The following table summarizes the estimated fair value of intangible assets acquired, their estimated useful lives and the amortization in the Consolidated Statements of Operations for the year ended December 31, 2012:

	Fair Value	Estimated Life (years)	Amortization Expense
Amortization expense:			
Cost of revenue:			
Existing technology	$ 1,560	5	$ 26
Sales and marketing:			
Customer relationships	290	7	3
Backlog	760	2	32
Tradenames	290	3	8
General and administrative:			
Non-solicitation agreements	120	1	10
Total	$ 3,020		79

The fair value of the acquired intangible assets was determined using a discounted cash flow valuation methodology using Level 3 inputs.

The operating results of Attributor are included in the Company s results of operations since the date of acquisition.

Unaudited Actual and Pro Forma Information

Our consolidated revenues for the year ended December 31, 2012 included $0.2 million from Attributor and our consolidated net income for the year ended December 31, 2012 included a $0.2 million net loss from Attributor subsequent to the acquisition date and without any intercompany allocations. Both revenues and the net loss from Attributor for the year ended December 31, 2012 were negatively impacted by a $0.2 million purchase accounting adjustment.

The following table presents the unaudited pro forma results for the periods set forth below. The unaudited pro forma financial information combines the results of operations as though the acquisition had occurred on January 1, 2011. No pro forma adjustments have been made for our incremental transaction or integration-related costs. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had occurred on January 1, 2011: (in thousands):

	Pro-Forma Year Ended December 31, 2012 *(unaudited)*	Pro-Forma Year Ended December 31, 2011 *(unaudited)*
Revenue	$ 49,273	$ 39,445
Net income	$ 6,807	$ 2,265
Net income per common share basic	$ 0.95	$ 0.33

Net income per common share diluted	$	0.92	$	0.30

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(In thousands, except share and per share data)

The pro forma information above includes the following pro forma adjustments that effected net income (in thousands):

	Year Ended December 31, 2012 *(unaudited)*	Year Ended December 31, 2011 *(unaudited)*
Revenue adjustment	$ 145	$ (233)
Amortization expense	(830)	(950)
Stock-based compensation expense	(505)	(505)
Direct transaction costs	190	(190)
Income tax benefit	834	1,747
Total impact to net income of pro forma adjustments	$ (166)	$ (131)

(5) ***Patent Licensing Arrangement with Intellectual Ventures***

On October 5, 2010, the Company entered into a patent licensing arrangement with IV Digital Multimedia Inventions, LLC, a Delaware limited liability company affiliated with Intellectual Ventures (IV), pursuant to which the Company granted an exclusive license to sublicense, subject to pre-existing encumbrances and a grant-back license, 597 patents and 288 patent applications held by the Company.

The Company also assigned to IV the related causes of action and other enforcement rights and IV has the sole right, but not the obligation, to prepare, file, prosecute, maintain, defend and enforce the licensed patents at its expense. IV may at any time abandon its license or other rights to all or any of the licensed patents, in which case, certain licensed patents that IV opts to release revert back to the Company.

The Company also entered into a patent rights agreement pursuant to which the Company granted IV an exclusive call option to purchase all or any number of the licensed patents and/or patent applications. The agreement further provides for the grant by IV to the Company the right to put all or any number of patents within the licensed patents to IV if IV threatens or commences an action or proceeding with respect to infringement of a licensed patent.

The financial aspects of the IV agreement for the Company include:

a license issue fee of $36 million, paid to the Company in increasing quarterly installments over three years ($11,400 in 2011, $12,550 in 2012 and $6,775 in 2013);

20% of the profits generated from the IV licensing program, which profits consist of sublicensing and other monetization revenue less specified expenses, including the license issue fee;

IV assumes responsibility for approximately $1 million per year in prosecution and maintenance costs previously borne by the Company;

a minimum of $4 million of paid support services over five years from the Company to assist IV in maximizing the value of the licensed assets; and

a royalty-free grant-back license to the licensed patents to continue the Company s existing business related to those assets, including maintaining and renewing existing patent licenses, and providing software and services.

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The payment terms extend beyond the Company s normal 30 to 60 day payment terms, thus the license revenue is being recognized when the installments are due, and the support services will be recognized as the services are performed.

(6) Segment Information

Geographic Information

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

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

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Domestic	$ 30,736	$ 22,660	$ 19,034
International (1)	13,639	13,379	12,116
Total	$ 44,375	$ 36,039	$ 31,150

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

Major Customers

Customers who accounted for more than 10% of the Company s revenues are as follows:

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
IV	30%	33%	18%
Verance Corporation (Verance)	27%	*	*
Central Banks	23%	27%	30%
The Nielsen Company (Nielsen)	*	11%	12%
Arbitron			14%

* Less than 10%

(7) Stock-Based Compensation

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

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

Determining Fair Value

Preferred Stock

The Board of Directors authorized 10,000 shares of Series A Redeemable Nonvoting Preferred stock (Series A Preferred) that were issued to certain executive officers at the time of formation. The Series A Preferred has no voting rights, except as required by law, and may be redeemed at the option of the Company s Board of Directors at any time on or after June 18, 2013.

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The Series A Preferred is redeemable based on the stated fair value of $5.00 per share. The Series A Preferred has no dividend rights and no rights to the undistributed earnings of the Company.

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 used is derived using a formula which uses 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.

A summary of the weighted average assumptions and results for options granted are as follows:

	Year Ended December 31, 2012	**Year Ended December 31, 2011**	**Year Ended December 31, 2010**
Expected life (in years)	N/A	5.28 5.75	5.2 6.0
Expected volatility	N/A	42% 44%	52% 55%
Risk-free interest rate	N/A	1.0% 2%	2.5% 3.0%
Expected dividend yield	N/A	0%	0%

	Year Ended December 31, 2012	**Year Ended December 31, 2011**	**Year Ended December 31, 2010**
Fair value of stock options granted	$	$ 2,464	$ 1,159

Expected Forfeitures. The Company uses a zero forfeiture for both the stock options granted to employees, which vest monthly, and the stock options granted to the Company s directors. Initial option grants, for new directors, vest 50% on the first anniversary of the date of grant and then monthly thereafter, and annual option grants, for continuing directors, vest monthly. The Company records stock-based compensation expense only for those awards that are expected to vest, including awards made to directors who are expected to continue with the Company through the year following the date of grant.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

Restricted Stock

The Compensation Committee of the Board of Directors has awarded restricted stock shares under the Company s 2008 Stock Incentive Plan to certain employees and directors. The shares subject to the restricted stock awards vest over a certain period, usually three to four years for employees and one year for directors, following the date of the grant. Specific terms of the restricted stock awards are governed by Restricted Stock Agreements between the Company and the award recipients. Restricted stock awards are treated as outstanding when granted.

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, including awards made to directors who are expected to continue with the Company through the year following the date of grant.

Stock-based Compensation

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Stock-based compensation:			
Cost of revenue	$ 603	$ 593	$ 373
Sales and marketing	409	302	192
Research, development and engineering	840	560	314
General and administrative	3,148	2,568	2,083
Intellectual property	256	193	106
Stock compensation expense	5,256	4,216	3,068
Capitalized to patent costs	108	65	37
Total stock-based compensation	$ 5,364	$ 4,281	$ 3,105

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

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Unrecognized compensation costs	$ 8,333	$ 9,463	$ 6,212

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 December 31, 2012 for stock options and restricted stock over a weighted average periods through December 2016 as follows:

	Stock Options	Restricted Stock
Weighted average period	1.13 years	1.46 years

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(8) Net Income 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 as the Company s unvested restricted stock is a participating security given these awards contain non-forfeitable rights to receive dividends. Under the two-class method, net 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 net earnings allocable to common shares by the weighted-average number of common shares outstanding for the period. Diluted earnings per common share is calculated by dividing net earnings allocable to common shares by the weighted-average number of common shares as of the balance sheet date, as adjusted for the potential dilutive effect of non-participating securities. The following table reconciles earnings per common share for the year ended December 31, 2012:

		Year Ended December 31, 2012
Basic EPS:		
Net income	$	8,272
Less: Net income allocable to participating securities		(426)
Net income allocable to common shares	$	7,846
Weighted average common shares outstanding basic (in thousands)		6,757
Basic earnings per common share	$	1.16

		Year Ended December 31, 2012
Diluted EPS:		
Net income	$	8,272
Less: Net income allocable to participating securities		(426)
Net income allocable to common shares	$	7,846
Weighted average common shares outstanding basic (in thousands)		6,757
Dilutive effect of non-participating securities (in thousands)		232
Weighted average common shares outstanding dilutive (in thousands)		6,989
Diluted earnings per common share	$	1.12

There were 215,000 common stock equivalents related to stock options that were anti-dilutive and excluded from diluted net income per share calculations for the year ended December 31, 2012 as their exercise prices were higher than the average market price of the underlying common stock for the period.

Net income per common share was calculated under the treasury stock method in prior periods because the impact of applying the two-class method for computing basic and diluted earnings per common share was not material. Basic and diluted net income per share were computed using the weighted average number of common shares outstanding during each period, with diluted net income per share including the effect of potentially dilutive common shares.

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(In thousands, except share and per share data)

	Year Ended December 31, 2011			Year Ended December 31, 2010		
	Income (Numerator)	Shares (in thousands) (Denominator)	Per Share Amount	Income (Numerator)	Shares (in thousands) (Denominator)	Per Share Amount
Basic EPS						
Income available to common shareholders	$ 5,656	6,741	$ 0.84	$ 4,174	7,120	$ 0.59
Effect of Dilutive Securities						
Options		393			440	
Restricted stock		296			63	
Diluted EPS						
Income available to common shareholders	$ 5,656	7,430	$ 0.76	$ 4,174	7,623	$ 0.55

There were 136,957 common stock equivalents related to stock options that were anti-dilutive and excluded from diluted net income per share calculations for 2011 as their exercise prices were higher than the average market price of the underlying common stock for the period.

There were no common stock equivalents related to stock options that were anti-dilutive for 2010 because their exercise prices were lower than the average market price of the underlying common stock for the period.

(9) Trade Accounts Receivable and Allowance for Doubtful Accounts

Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount.

	December 31, 2012	December 31, 2011
Trade accounts receivable	$ 4,216	$ 3,502
Allowance for doubtful accounts		
Trade accounts receivable, net	$ 4,216	$ 3,502
Unpaid deferred revenue included in accounts receivable	$ 1,589	$ 2,084

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 monthly. Account balances are charged against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

Unpaid deferred revenue

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

Major customers

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

	December 31, 2012	December 31, 2011
Central Banks	30%	45%
Nielsen	24%	29%
Civolution	14%	14%

(10) Property and Equipment

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.

	December 31, 2012	December 31, 2011
Office furniture and fixtures	$ 420	$ 410
Equipment	1,886	1,872
Leasehold improvements	1,083	1,041
Gross property and equipment	3,389	3,323
Less accumulated depreciation and amortization	(1,936)	(1,928)
Property and equipment, net	$ 1,453	$ 1,395

Leases

Future minimum lease payments under non-cancelable operating leases are as follows:

Year ending December 31:	Operating Leases

2013	$	893
2014		890
2015		920
2016		628
2017		
Thereafter		
Total minimum lease payments	$	3,331

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Rent expense on the operating leases are as follows:

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Rent expense	$ 776	$ 866	$ 832

(11) 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 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.

	Estimated Life (years)	December 31, 2012	December 31, 2011
Capitalized patent costs	17-20	$ 3,973	$ 3,035
Intangible assets acquired:			
Purchased patents and intellectual property	3-10	250	13
Existing technology	5	1,560	
Customer relationships	7	290	
Backlog	2	760	
Tradenames	3	290	
Non-solicitation agreements	1	120	
Gross intangible assets		7,243	3,048
Accumulated amortization		(522)	(240)
Intangible assets, net		$ 6,721	$ 2,808

The aggregate amortization expense recorded in 2012, 2011 and 2010 was $315, $124 and $79, respectively. For intangible assets recorded at December 31, 2012, the estimated future aggregate amortization expense for the years ending December 31, 2012 through 2017 is approximately:

Year ending December 31:	Amortization Expense
2013	$ 1,061

2014	975
2015	572
2016	477
2017	441

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(12) Shareholders Equity

Preferred Stock

In June 2008, the Board of Directors authorized 2,500,000 shares of preferred stock, par value $0.001 per share. The Board of Directors has the authority to issue the undesignated preferred stock in one or more series and to determine the powers, preferences and rights and the qualifications, limitations or restrictions granted to or imposed upon any wholly unissued series of undesignated preferred stock and to fix the number of shares constituting any series and the designation of such series, without any further vote or action by the shareholders. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change of control of the Company without further action by shareholders and may adversely affect the voting and other rights of the holders of common stock.

The Board of Directors authorized 10,000 shares of Series A Redeemable Nonvoting Preferred stock (Series A Preferred) that were issued to certain executive officers at the time of formation. The Series A Preferred has no voting rights, except as required by law, and may be redeemed at the option of the Company s Board of Directors at any time on or after June 18, 2013.

The Series A Preferred is redeemable based on the stated fair value of $5.00 per share. The Series A Preferred has no dividend rights and no rights to the undistributed earnings of the Company.

Common Stock

In June 2008, the Board of Directors authorized 50,000,000 shares of common stock, par value $0.001 per share. The holders of Digimarc common stock are entitled to one vote for each share held of record on all matters submitted to a vote of our shareholders, including the election of directors. Subject to preferences that may be granted to any then outstanding preferred stock, holders of common stock are entitled to receive ratably those dividends as may be declared by the Board of Directors out of funds legally available for such purpose, as well as any distributions to the Company s shareholders. The Series A Preferred does not have any dividend preferences. In the event of the Company s liquidation, dissolution or winding up, holders of common stock are entitled to share ratably in all of the Company s assets remaining after payment of liabilities and the liquidation preference of any then outstanding preferred stock. Holders of common stock have no preemptive or other subscription or conversion rights. There are no redemption or sinking fund provisions applicable to the common stock. All outstanding shares of common stock are fully paid and non-assessable.

Stock Incentive Plan

On July 31, 2008 the Company s Board of Directors initially adopted the 2008 Incentive Plan, or the 2008 Plan. The 2008 Plan provides for the grant of stock options, stock appreciation rights, stock awards, restricted stock, stock units, performance shares, performance units, and cash-based awards, which may be granted to officers, directors, employees, consultants, agents, advisors and independent contractors who provide services to the Company and its affiliated companies.

The 2008 Plan authorizes the issuance of up to 2,500,000 shares of common stock. The shares authorized under the 2008 Plan are subject to adjustment in the event of a stock split, stock dividend, recapitalization or similar event. Shares issued under the 2008 Plan will consist of authorized and unissued shares or shares held by the Company as treasury shares. If an award granted under the 2008 Plan lapses, expires, terminates or is forfeited or surrendered without having been fully exercised or without the issuance of all the shares subject to

DIGIMARC CORPORATION

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(In thousands, except share and per share data)

the award, the shares covered by that award will again be available for use under the 2008 Plan. Shares that are (i) tendered by a participant or retained by the Company as payment for the purchase price of an award or to satisfy tax withholding obligations or (ii) covered by an award that is settled in cash, or in some manner that some or all of the shares covered by the award are not issued, will be available for issuance under the 2008 Plan. In addition, awards granted as substitute awards in connection with acquisition transactions will not reduce the number of shares authorized for issuance under the 2008 Plan.

Stock Options

As of December 31, 2012, under all of the Company s stock-based compensation plans, equity awards to purchase an additional 799,415 shares were authorized for future grants under the plans. The Company issues new shares upon option exercises.

Options granted, exercised, canceled and expired under the stock incentive plan are summarized as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Options outstanding, December 31, 2009	1,167,323	$ 9.65	$ 6.28	
Granted	140,000	$ 15.64	$ 8.28	
Exercised	(313,832)	$ 9.70	$ 6.32	
Canceled				
Options outstanding, December 31, 2010	993,491	$ 10.47	$ 6.55	
Granted	215,000	$ 27.84	$ 11.46	
Exercised	(169,420)	$ 9.75	$ 6.33	
Canceled	(10,833)	$ 9.64	$ 6.28	
Options outstanding, December 31, 2011	1,028,238	$ 14.23	$ 7.61	
Granted				
Exercised	(172,250)	$ 9.64	$ 6.29	
Canceled				
Options outstanding, December 31, 2012	855,988	$ 15.16	$ 7.88	$ 6,280
Options exercisable, December 31, 2012	693,248	$ 12.78		$ 6,110
Options unvested, December 31, 2012	162,740	$ 25.28		$ 170

The aggregate intrinsic value is based on the closing price of $20.70 per share of Digimarc common stock on December 31, 2012, which would have been received by the optionees had all of the options with exercise prices less than $20.70 per share been exercised on that date.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

The following table summarizes information about stock options outstanding at December 31, 2012:

	Options Outstanding			Options Exercisable		
Exercise Price	Number Outstanding	Remaining Contractual Life (Years)	Weighted Average Price	Number Exercisable	Remaining Contractual Life (Years)	Weighted Average Price
$9.64 $9.91	508,072	5.86	$ 9.66	508,072	5.86	$ 9.66
$14.99 $18.01	132,916	7.08	$ 15.67	103,126	7.10	$ 15.87
$24.35 $30.01	215,000	8.57	$ 27.84	82,050	8.49	$ 28.26
$9.64 $30.01	855,988	6.73	$ 15.16	693,248	6.36	$ 12.78

Restricted Stock

The Compensation Committee of the Board of Directors awarded restricted stock shares under the Company s 2008 Plan to certain employees. The shares subject to the restricted stock awards will vest over a certain period, usually four years, following the date of the grant. Specific terms of the restricted stock awards are governed by Restricted Stock Agreements between the Company and the award recipients.

The following table reconciles the unvested balance of restricted stock:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested balance, December 31, 2009	111,000	$ 10.02
Granted	124,560	$ 16.77
Vested	(34,350)	$ 9.89
Canceled	(3,450)	$ 13.05
Unvested balance, December 31, 2010	197,760	$ 14.25
Granted	190,180	$ 29.12
Vested	(73,110)	$ 20.82
Canceled	(18,120)	$ 19.24
Unvested balance, December 31, 2011	296,710	$ 21.51
Granted	202,340	$ 22.51
Vested	(117,667)	$ 22.52
Canceled	(12,300)	$ 22.05
Unvested balance, December 31, 2012	369,083	$ 21.72

(13) Defined Contribution Pension Plan

The Company sponsors an employee savings plan (the Plan) which qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. The Plan combines both an employee savings plan and company matching plan into one plan under Section 401(k), including a 401(k) Roth option. Employees become eligible to participate in the Plan at the beginning of the month following the employee s hire date. Employees may contribute up to 75% of their pay to the Plan, subject to the limitations of the Internal Revenue Code. Company matching contributions are mandatory. The previous Plan was terminated as of December 31, 2008.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

The Company made matching contributions in the aggregate amount as follows:

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Matching contributions	$ 366	$ 349	$ 323

(14) Joint Venture and Related Party Transactions

In June 2009, the Company entered into two joint venture agreements with Nielsen to launch two new companies; TVaura LLC (in which Digimarc holds a 51% ownership interest) and TVaura Mobile LLC (in which Digimarc holds a 49% ownership interest). The two joint venture agreements and a revised patent license agreement expanded and replaced the previous license and services agreement between the Company and Nielsen that had been in operation since late 2007. Under the new agreements, the Company and Nielsen agreed to work together to develop new products and services, including the expansion and deployment of those products and services that were in development under the prior agreement.

Under the terms of the patent license agreement, Nielsen agreed to pay Digimarc $18,750 during the period from July 2009 through January 2014, and Digimarc granted to Nielsen a non-exclusive license to Digimarc s patents for use within Nielsen s business. Unless earlier terminated in accordance with the agreement, the license will continue until the expiration of the last to expire of the licensed patents. The payment terms extend beyond the Company s normal 30 to 60 day payment terms, thus the license revenue is being recognized when the installments are due.

The Company provided technical and development services to the joint ventures totaling $6,848 during the period 2009 through 2012. Service revenue was recognized as the services are performed.

The Company and Nielsen each made initial cash contributions aggregating $3,500 payable quarterly from July 2009 through July 2011 to fund TVaura LLC and initial cash contributions aggregating $2,500 payable quarterly from July 2009 through July 2011 to fund TVaura Mobile LLC.

In March 2012, Digimarc and Nielsen decided to reduce the investments in their two joint ventures to minimal levels while assessing alternative approaches to achieving each of their goals in the emerging market opportunity of synchronized second screen television. In connection with this plan for the suspension of operations, the joint ventures accrued estimated expenses for the first quarter s operations and severance costs for joint venture employees. Digimarc s share of the one-time severance and suspension costs was approximately $500. Pursuant to the plan of suspending operations of the joint ventures with Nielsen, in April 2012 the Company received $104 of remaining cash from TVaura LLC and contributed $796 to TVaura Mobile LLC to fund both the first quarter s operating expenses as well as the suspension related costs. 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 December 31, 2012, both Digimarc and Nielsen continued to assess the market opportunities of each of the joint ventures.

The investment in joint ventures account balances have been reduced to $0 as of December 31, 2012.

Pursuant to the terms of the agreements and ASC 810 *Consolidation,* the joint ventures are not consolidated with the Company because the minority member has substantive participating rights, or veto rights, such that no member has majority control.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

Related Party Transactions

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
TVaura LLC:			
Capital contributions (return of capital)	$ (104)	$ 1,200	$ 1,600
Revenue (1)	$	$ 2,640	$ 2,723
TVaura Mobile LLC:			
Capital contributions	$ 796	$ 900	$ 1,200
Revenue (1)	$ 272	$	$
Total:			
Capital contributions, net	$ 692	$ 2,100	$ 2,800
Revenue (1)	$ 272	$ 2,640	$ 2,723

(1) Technical and development services

Summarized financial data for TVaura LLC:

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Current assets	$	$ 402	$ 777
Noncurrent assets	$	$ 22	$ 31
Current liabilities	$	$ 169	$ 255
Noncurrent liabilities	$	$	$

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Revenue	$	$	$
Gross profit	$	$	$
Operating expenses	$ 52	$ 2,699	$ 2,825
Net loss from continuing operations	$ (52)	$ (2,699)	$ (2,824)
The Company s pro-rata share net loss	$ (27)	$ (1,376)	$ (1,440)
The Company s gain on investment	$ 70	$	$

Summarized financial data for TVaura Mobile LLC:

	Year Ended December 31, 2012		Year Ended December 31, 2011		Year Ended December 31, 2010	
Current assets	$	937	$	1,308	$	1,913
Noncurrent assets	$		$		$	
Current liabilities	$	957	$	720	$	382
Noncurrent liabilities	$		$		$	

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	Year Ended December 31, 2012		Year Ended December 31, 2011		Year Ended December 31, 2010	
Revenue	$		$	105	$	
Gross profit	$		$	105	$	
Operating expenses	$	2,266	$	2,848	$	1,532
Net loss from continuing operations	$	(2,266)	$	(2,743)	$	(1,532)
The Company s pro-rata share net loss	$	(1,100)	$	(1,338)	$	(740)
The Company s loss on investment	$	(50)	$		$	

(15) Income Taxes

For the year ended December 31, 2012, the provision for income taxes reflects current tax expense, deferred tax expense and withholding tax expense in various foreign jurisdictions. The withholding taxes are computed by the Company s customers and paid to foreign jurisdictions on the Company s behalf. The effective tax rate for the year ended December 31, 2012 was 39%. Excess tax benefits associated with stock compensation are being utilized in the current year to offset tax payable and credit additional paid-in capital.

For the year ended December 31, 2011, the provision for income taxes reflects current tax expense, deferred tax benefit and withholding tax expense in various foreign jurisdictions. The effective tax rate for the year ended December 31, 2011 was a tax benefit of 46%. Excess tax benefits associated with stock compensation were being utilized in 2011 to offset tax payable and credit additional paid-in capital. The Company recognized a deferred

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

tax benefit of $2,581 during the year ended December 31, 2011 as a result of releasing the valuation allowance on deferred tax assets. The Company concluded, based on an analysis of all the facts, including projections of future income, that it was more likely than not that all of its deferred tax assets will be realized.

Components of tax expense (benefit) allocated to continuing operations include the following:

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Current:			
Federal	$ 4,699	$ 1,066	$
State	570	3	
Foreign	1	(20)	42
Sub-total	5,270	1,049	42
Deferred:			
Federal	97	(2,470)	
State	27	(365)	
Foreign			
Sub-total	124	(2,835)	
Total tax (benefit) expense	$ 5,394	$ (1,786)	$ 42

The reconciliation of the statutory federal income tax rate to the Company s effective income tax rate is as follows:

	Year Ended December 31, 2012	%	Year Ended December 31, 2011	%	Year Ended December 31, 2010	%
Income taxes computed at statutory rates	$ 4,647	34%	$ 1,316	34%	$ 1,434	34%
Increases (decreases) resulting from:						
State income taxes, net of federal tax benefit	705	5%	194	5%	220	5%
Federal and state research and experimentation credits	(122)	(1)%	(784)	(20)%	(353)	
Change in valuation allowance	12		(2,581)	(67)%	(1,275)	(32)%
Transaction costs	65	1%				
Impact of federal graduated rates	39					
Other	48		69	2%	16	
Total	$ 5,394	39%	$ (1,786)	(46)%	$ 42	7%

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The tax effects of significant items comprising the Company s deferred tax assets and deferred tax liabilities are as follows:

	December 31, 2012	December 31, 2011
Deferred tax assets:		
Stock based compensation	$ 2,636	$ 1,976
Federal and state net operating losses	1,900	
Goodwill	1,146	1,254
Accrued compensation	50	
Deferred rent	170	190
Federal and state research and experimentation credits		458
Other		21
Total gross deferred tax assets	5,902	3,899
Less valuation allowance	(184)	
Net deferred tax assets	$ 5,718	$ 3,899
Deferred tax liabilities:		
Patent expenditures	$ (1,385)	$ (1,051)
Fixed asset differences	(167)	(13)
Intangible asset differences	(506)	(13)
Other	(18)	(13)
Total deferred tax liabilities	$ (2,076)	$ (1,064)
Net deferred tax assets	$ 3,642	$ 2,835

For the year ended December 31, 2012, the Company acquired 100% of the outstanding stock of Attributor Corporation in a non-taxable transaction. Due to Attributor s history of losses and the inability to utilize Attributor losses to offset the Company s income for state tax purposes, the Company concluded that it is not more likely than not that the Attributor state deferred tax assets will be realized and a full valuation allowance has been recorded on the state deferred tax assets of Attributor. The valuation allowance recorded as of December 31, 2012 and 2011 is $184 and $0, respectively, and relates to state deferred tax assets acquired as part of the Attributor acquisition.

For the year ended December 31, 2011, the Company determined that it was more likely than not that the net deferred tax assets would be realized and the entire valuation allowance in the amount of $2,581 was released.

As of December 31, 2012, the Company has federal and state net operating loss carry-forwards of $4,873 and $4,873, respectively, which have a carry-forward of 8 20 years depending on the jurisdiction. The deferred tax assets, before valuation allowance, for federal and state net operating loss carryforwards acquired in the Attributor acquisition have been reduced to the amount of losses allowed to be utilized in the post-acquisition period before expiration after considering the applicable limitations of IRC Sec. 382. As of December 31, 2012, the Company has federal and state research and experimental tax credits of $49 and $12, respectively, which have a carry-forward of 5 19 years depending on the jurisdiction and for which the benefits upon usage will be

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

recorded in additional paid-in capital from the effects of stock options. As of December 31, 2012, the Company has foreign tax credits of $56 which have a carry-forward of 7 9 years and for which the benefits upon usage will be recorded in additional paid-in capital from the effects of stock options.

The Company records accrued interest and penalties associated with uncertain tax positions in income tax expense in the consolidated statements of operations. On initial adoption of ASC 740 and through December 31, 2010, the Company recognized no uncertain tax positions nor accrued interest and penalties associated with uncertain tax positions. For the years ended December 31, 2012 and 2011, the Company recognized uncertain tax positions and no accrued interest and penalties associated with uncertain tax positions. The Company does not anticipate any unrecognized benefits that will significantly increase or decrease within the next 12 months.

A summary reconciliation of the Company s uncertain tax positions is as follows:

	December 31, 2012	December 31, 2011
Beginning balance	$ 102	$
Addition for current year tax positions	6	30
Addition for prior year tax positions		72
Settlements with taxing authorities		
Lapsing of statutes of limitations		
Ending balance	$ 108	$ 102

The balance for uncertain tax positions is classified as a long-term liability on the consolidated balance sheet. All uncertain tax positions if reversed would affect the effective tax rate.

The Company is subject to examination in the federal jurisdiction for the tax years ending December 31, 2012, 2011 and 2010 and other state jurisdictions for the tax years ending December 31, 2012, 2011, 2010, 2009 and 2008.

(16) 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.

Our newly acquired subsidiary, Attributor, is a defendant in a patent infringement lawsuit brought by Blue Spike, LLC (E.D. Texas, Civil Action No: 6:12-cv-540). The case was brought against Attributor in August 2012, and was consolidated with other lawsuits brought by Blue Spike into Civil Action No. 6:12-cv-00499.

Blue Spike asserted infringement by Attributor of four patents. Attributor filed an answer denying that it has infringed any valid claim of the patents in suit, and asserting specified defenses, including non-infringement and invalidity.

The court is consolidating cases that Blue Spike brought against over sixty defendants into one case. After that process is complete, a schedule should be set.

Blue Spike has not alleged a specific amount of monetary damages in its Complaint.

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

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

(17) Stock Repurchases

Summary of common stock shares repurchased:

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Private transaction		552,536	
Repurchase program	50,900	104,577	
Exercise of stock options	69,272	48,432	102,077
Tax withholding obligations on stock options	39,005	46,401	81,610
Tax withholding obligations on restricted shares	42,785	24,953	13,506
Total	201,962	766,899	197,193

Value of common stock shares repurchased:

	Year Ended December 31, 2012	Year Ended December 31, 2011	Year Ended December 31, 2010
Private transaction	$	$ 14,927	$
Repurchase program	1,201	3,099	
Exercise of stock options	1,660	1,651	3,037
Tax withholding obligations on stock options	949	1,658	2,435
Tax withholding obligations on restricted shares	950	713	352
Total	$ 4,760	$ 22,048	$ 5,824

On January 26, 2011, the Company repurchased 552,536 shares of its common stock from Koninklijke Philips Electronics, N.V., in a privately negotiated transaction. The shares were purchased for an aggregate price of approximately $14,927, including transaction fees. To facilitate the repurchase, the Company sold $10,752 and $2,996 of short- and long-term marketable securities, respectively, prior to their maturity date at an immaterial gain.

In each of April 2009 and November 2011, the Board of Directors approved a stock repurchase program authorizing the purchase, at the discretion of management, of shares of the Company s common stock through either periodic open-market or private transactions at then-prevailing market prices. Under the April 2009 program that expired in April 2012, the Company repurchased 223,851 shares at an aggregate purchase price of $4,858. Under the November 2011 program, the Board of Directors approved an additional $5,000. In December 2012, the program was extended through December 31, 2013. As of December 31, 2012, the Company had repurchased 43,293 shares under this program at an aggregate purchase price of $1,002.

As part of the Company s 2008 Stock Incentive Plan, stock options are granted and restricted stock shares are awarded to certain employees and directors.

Pursuant to the terms of the stock option grants, the Company purchases a number of whole shares of common stock having a fair market value (as determined as of the date of exercise) equal to the amount of the total value of the aggregate exercise price of the options exercised. In addition, the Company withholds

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(purchases) from shares issued upon exercise of the stock options a number of whole shares of common stock having a fair market value (as determined by the Company as of the date of vesting) equal to the amount of tax required to be withheld by law, in order to satisfy the tax withholding obligations of the Company in connection with the exercise of such options.

Pursuant to the terms of the restricted stock award agreement, the Company withholds (purchases) from fully vested shares of common stock otherwise deliverable to the employee, a number of whole shares of common stock having a fair market value (as determined as of the date of vesting) equal to the amount of tax required to be withheld by law, in order to satisfy the tax withholding obligations of the Company in connection with the vesting of such shares.

(18) Subsequent Events

On February 20, 2013, the Board of Directors declared a quarterly dividend of $0.11 per share, payable on March 11, 2013 to shareholders of record on March 4, 2013.

(19) Quarterly Financial Information Unaudited

Quarter ended:	March 31	June 30	September 30	December 31
2012				
Service revenue	$ 3,048	$ 2,609	$ 2,616	$ 2,519
License and subscription revenue	13,998	6,503	6,287	6,795
Total revenue	17,046	9,112	8,903	9,314
Total cost of revenue	1,810	1,583	1,467	1,648
Gross profit	15,236	7,529	7,436	7,666
Gross profit percent, service revenue	44%	44%	48%	45%
Gross profit percent, license and subscription revenue	99%	98%	98%	96%
Gross profit percent, total	89%	83%	84%	82%
Sales and marketing	$ 1,007	$ 970	$ 937	$ 913
Research, development and engineering	1,998	2,146	2,320	2,277
General and administrative	2,758	2,191	2,282	2,226
Intellectual property	319	291	309	329
Operating income	9,154	1,931	1,588	1,921
Net income	4,999	1,216	1,003	1,054
Earnings per common share:				
Net income per common share basic	$ 0.74	$ 0.17	$ 0.14	$ 0.15
Net income per common share diluted	$ 0.70	$ 0.17	$ 0.14	$ 0.14
Weighted average common shares outstanding basic	6,738	6,737	6,761	6,791
Weighted average common shares outstanding diluted	7,140	6,993	6,984	6,966

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DIGIMARC CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

Quarter ended:	March 31	June 30	September 30	December 31
2011				
Service revenue	$ 3,069	$ 3,165	$ 3,108	$ 3,053
License and subscription revenue	6,022	6,308	5,442	5,872
Total revenue	9,091	9,473	8,550	8,925
Total cost of revenue	1,649	1,690	1,742	1,856
Gross profit	7,442	7,783	6,808	7,069
Gross profit percent, service revenue	48%	49%	46%	42%
Gross profit percent, license and subscription revenue	99%	99%	99%	99%
Gross profit percent, total	82%	82%	80%	79%
Sales and marketing	$ 1,102	$ 1,017	$ 1,166	$ 1,051
Research, development and engineering	1,775	1,884	1,958	1,710
General and administrative	2,847	2,270	2,000	2,839
Intellectual property	301	266	259	268
Operating income	1,417	2,346	1,425	1,201
Net income	938	3,626	639	453
Earnings per common share:				
Net income per common share basic	$ 0.14	$ 0.54	$ 0.10	$ 0.07
Net income per common share diluted	$ 0.12	$ 0.50	$ 0.09	$ 0.06
Weighted average common shares outstanding basic	6,864	6,696	6,706	6,699
Weighted average common shares outstanding diluted	7,505	7,245	7,344	7,279

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EXHIBIT INDEX

The agreements included or incorporated by reference as exhibits to this report may contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties were made for the benefit of the other party or parties to the applicable agreement and:

- were not intended to be treated as categorical statements of fact, but rather as a means of allocating the risk to one of the parties if those statements prove to be inaccurate;

- were qualified by disclosures that were made to the other party or parties in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;

- may apply contract standards of materiality that are different from materiality under the securities laws; and

- were made only as of the date of the applicable agreement or other date or dates that may be specified in the agreement.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time. Additional information about Digimarc may be found elsewhere in this Annual Report on Form 10-K and in Digimarc s other public filings, which are available without charge through the SEC s website at http://www.sec.gov.

Exhibit Number	Exhibit Description
2.1	Separation Agreement among DMRC Corporation, DMRC LLC, Digimarc Corporation and, with respect to certain sections, L-1 Identity Solutions, Inc. (incorporated by reference to Exhibit 2.1 to Amendment No. 2 to the Company s Registration Statement on Form 10, filed with the Commission on August 13, 2008 (File No. 001-34108))
2.2	Agreement and Plan of Merger dated April 30, 2010 between Digimarc Corporation, a Delaware corporation, and Digimarc Oregon Corporation, an Oregon corporation (incorporated by reference to Exhibit 2.1 to the Company s Current Report on Form 8-K, filed with the Commission on May 4, 2010 (File No. 001-34108))
2.3	Agreement and Plan of Merger, dated December 3, 2012, by and among Digimarc, DA Sub Inc., a wholly owned subsidiary of Digimarc Corporation, Attributor, and Fortis Advisors LLC, as the representative for Attributor s security holders (incorporated by reference to Exhibit 2.1 to the Company s Current Report on Form 8-K, filed with the Commission on December 4, 2012 (File No. 001-34108))
3.1	Articles of Incorporation of Digimarc Corporation (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K, filed with the Commission on May 4, 2010 (File No. 001-34108))
3.2	Bylaws of Digimarc Corporation (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K, filed with the Commission on May 4, 2010 (File No. 001-34108))
4.1	Specimen common stock certificate of Digimarc Corporation (incorporated by reference to Exhibit 4.1 to the Company s Annual Report on Form 10-K, filed with the Commission on February 27, 2009 (File No. 001-34108))
4.2	Rights Agreement, dated July 31, 2008, between Digimarc Corporation and Computershare Trust Company, N.A. as Rights Agent (incorporated by reference to Exhibit 4.2 to the Company s Annual Report on Form 10-K, filed with the Commission on February 27, 2009 (File No. 001-34108))
4.3	Form of Certificate of Designation of Series R Preferred Stock (attached as an exhibit to the Rights Agreement filed as Exhibit 4.2 hereto)
4.4	Form of Rights Certificate (attached as an exhibit to the Rights Agreement filed as Exhibit 4.2 hereto)

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Exhibit Number	Exhibit Description
10.1	License Agreement between DMRC Corporation and L-1 Identity Solutions Operating Company (incorporated by reference to Exhibit 10.2 to Amendment No. 4 to the Company s Registration Statement on Form 10, filed with the Commission on October 2, 2008 (File No. 001-34108))(1)
10.2	Counterfeit Deterrence System Development and License Agreement, dated as of December 6, 2012, between Digimarc Corporation and the Bank for International Settlements (4)
*10.3	Form of Indemnification Agreement between DMRC Corporation and each of its executive officers and directors (incorporated by reference to Exhibit 10.5 to Amendment No. 2 to the Company s Registration Statement on Form 10, filed with the Commission on August 13, 2008 (File No. 001-34108))
*10.4	Employment Agreement, effective as of November 1, 2011, between Digimarc Corporation and Bruce Davis (incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K, filed with the Commission on November 7, 2011 (File No. 001-34108))
*10.5	Digimarc Corporation 2008 Incentive Plan (incorporated by reference to Exhibit 10.7 to the Company s Quarterly Report on Form 10-Q, filed with the Commission on November 24, 2008 (File No. 001-34108))
*10.6	Form of Notice of Stock Option Award and Stock Option Award Agreement under the Digimarc Corporation 2008 Incentive Plan (incorporated by reference to Exhibit 10.8 to the Company s Quarterly Report on Form 10-Q, filed with the Commission on November 24, 2008 (File No. 001-34108))
*10.7	Equity Compensation Program for Nonemployee Directors under the Digimarc Corporation 2008 Incentive Plan (incorporated by reference to Exhibit 10.9 to the Company s Quarterly Report on Form 10-Q, filed with the Commission on November 24, 2008 (File No. 001-34108))
*10.8	Form of Indemnification Agreement between Digimarc Corporation and each of its executive officers and directors (incorporated by reference to Exhibit 10.1 to Digimarc Corporation s Annual Report on Form 10-K, as filed by Digimarc Corporation with the Securities and Exchange Commission on March 13, 2006 (File No. 000-28317))
*10.9	Form of Change of Control Retention Agreement entered into by and between Digimarc Corporation and each of Messrs. McConnell, Chamness, Knudson and Meyer (filed as Exhibit 10.9 to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
10.10	Patent License Agreement, dated as of June 11, 2009 between Digimarc Corporation and The Nielsen Company (US), LLC (incorporated by reference to Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q, filed with the Commission on July 31, 2009 (File No. 001-34108))(2)
10.11	Limited Liability Company I Agreement, dated June 11, 2009 between Digimarc Corporation and The Nielsen Company (US), LLC (incorporated by reference to Exhibit 10.2 to the Company s Quarterly Report on Form 10-Q, filed with the Commission on July 31, 2009 (File No. 001-34108))(2)
10.12	Limited Liability Company II Agreement, dated June 11, 2009 between Digimarc Corporation and The Nielsen Company (US), LLC (incorporated by reference to Exhibit 10.3 to the Company s Quarterly Report on Form 10-Q, filed with the Commission on July 31, 2009 (File No. 001-34108))(2)

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Exhibit Number	Exhibit Description
10.13	Lease Agreement, dated March 22, 2004, between Digimarc Corporation and PS Business Parks, L.P., as amended on May 13, 2010 (incorporated by reference to Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q, filed with the Commission on July 30, 2010 (File No. 001-34108))
10.14	Patent License Agreement, effective as of October 5, 2010, between Digimarc Corporation and IV Digital Multimedia Inventions, LLC (incorporated by reference to Exhibit 10.12 to the Company s Annual Report on Form 10-K, filed with the Commission on March 3, 2011 (File No. 001-34108)) (3)
10.15	Grant-Back License Agreement, dated October 5, 2010, between Digimarc Corporation and IV Digital Multimedia Inventions, LLC (incorporated by reference to Exhibit 10.13 to the Company s Annual Report on Form 10-K, filed with the Commission on March 3, 2011 (File No. 001-34108)) (3)
10.16	Patent Rights Agreement, dated October 5, 2010, between Digimarc Corporation and IV Digital Multimedia Inventions, LLC (incorporated by reference to Exhibit 10.14 to the Company s Annual Report on Form 10-K, filed with the Commission on March 3, 2011 (File No. 001-34108))
10.17	Work Agreement, dated October 5, 2010, by and among Digimarc Corporation, Invention Law Group, P.C. and IV Digital Multimedia Inventions, LLC (incorporated by reference to Exhibit 10.15 to the Company s Annual Report on Form 10-K, filed with the Commission on March 3, 2011 (File No. 001-34108)) (3)
21.1	List of Affiliates (filed as Exhibit 21.1 to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
23.1	Consent of Independent Registered Public Accounting Firm
23.2	Consent of Independent Registered Public Accounting Firm
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer (filed as Exhibit 31.1 to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer (filed as Exhibit 31.2 to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
31.3	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.4	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer (filed as Exhibit 32.1 to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
32.2	Section 1350 Certification of Chief Financial Officer (filed as Exhibit 32.2 to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
32.3	Section 1350 Certification of Chief Executive Officer
32.4	Section 1350 Certification of Chief Financial Officer
101.INS(a)	XBRL Instance Document (filed as Exhibit 101.INS to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
101.INS(b)	XBRL Instance Document
101.SCH(a)	XBRL Taxonomy Extension Schema Document (filed as Exhibit 101.SCH to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
101.SCH(b)	XBRL Taxonomy Extension Schema Document
101.CAL(a)	XBRL Taxonomy Extension Calculation Linkbase Document (filed as Exhibit 101.CAL to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
101.CAL(b)	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF(a)	XBRL Taxonomy Extension Definition Linkbase Document (filed as Exhibit 101.DEF to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
101.DEF(b)	XBRL Taxonomy Extension Definition Linkbase Document

101.LAB(a)	XBRL Taxonomy Extension Label Linkbase Document (filed as Exhibit 101.LAB to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
101.LAB(b)	XBRL Taxonomy Extension Label Linkbase Document
101.PRE(a)	XBRL Taxonomy Extension Label Linkbase Document (filed as Exhibit 101.PRE to the Company s Annual Report on Form 10-K, filed with the Commission on February 22, 2013 (File No. 001-34108))
101.PRE(b)	XBRL Taxonomy Extension Label Linkbase Document

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* Management contract or compensatory plan or arrangement.

Schedules and certain exhibits to this agreement have been omitted pursuant to Item 601(b)(2) of Regulation S-K. Digimarc hereby undertakes to furnish to the Securities and Exchange Commission (the Commission) copies of the omitted schedules and exhibits upon request by the Commission.

(1) Confidential treatment has been granted for certain portions omitted from this exhibit pursuant to an order granted by the Commission on October 21, 2008, under Rule 24b-2 of the Securities Exchange Act of 1934, as amended. Confidential portions of this exhibit have been separately filed with the Securities and Exchange Commission.

(2) Confidential treatment has been granted for certain portions omitted from this exhibit pursuant to an order granted by the Commission on September 10, 2009, under Rule 24b-2 under the Securities Exchange Act of 1934, as amended. Confidential portions of this exhibit have been separately filed with the Securities and Exchange Commission.

(3) Confidential treatment has been granted for certain portions omitted from this exhibit pursuant to an order granted by the Commission on March 17, 2011, under Rule 24b-2 under the Securities Exchange Act of 1934, as amended. Confidential portions of this exhibit have been separately filed with the Securities and Exchange Commission.

(4) Confidential treatment has been requested for certain portions omitted from this exhibit pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, as amended. Confidential portions of this exhibit have been separately filed with the Securities and Exchange Commission.