

VASCO DATA SECURITY INTERNATIONAL INC

Form 10-Q

August 02, 2013

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

**FOR THE QUARTERLY PERIOD ENDED June 30, 2013**

**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 000-24389**

**VASCO Data Security International, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

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**DELAWARE**  
(State or Other Jurisdiction of

**36-4169320**  
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

**1901 South Meyers Road, Suite 210**

**Oakbrook Terrace, Illinois 60181**

(Address of Principal Executive Offices)(Zip Code)

**(630) 932-8844**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐ (do not check if 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

There were 39,473,744 shares of Common Stock, \$.001 par value per share, outstanding at July 26, 2013.

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**VASCO Data Security International, Inc.**

**Form 10-Q**

**For The Quarterly Period Ended June 30, 2013**

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*This report may contain trademarks of VASCO Data Security International, Inc. and its subsidiaries, which include VASCO, the VASCO V design, DIGIPASS, Digipass as a Service (DPS), MYDIGIPASS.COM, VACMAN, aXsGUARD and IDENTIKEY.*

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**VASCO Data Security International, Inc.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except per share data)

(unaudited)

	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and equivalents	\$ 85,649	\$ 106,469
Accounts receivable, net of allowance for doubtful accounts of \$663 in 2013 and \$1,894 in 2012	25,961	27,574
Inventories	25,488	18,675
Prepaid expenses	1,916	1,896
Foreign sales tax receivable	734	415
Deferred income taxes	677	1,714
Other current assets	60	41
Assets of discontinued operations	2,113	2,651
<b>Total current assets</b>	<b>142,598</b>	<b>159,435</b>
Property and equipment:		
Furniture and fixtures	5,000	5,035
Office equipment	8,882	8,718
	13,882	13,753
Accumulated depreciation	(10,412)	(9,701)
Property and equipment, net	3,470	4,052
Goodwill, net of accumulated amortization	22,001	13,176
Intangible assets, net of accumulated amortization	18,729	6,507
Other assets, net of accumulated amortization	2,840	3,336
<b>Total assets</b>	<b>\$ 189,638</b>	<b>\$ 186,506</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 6,323	\$ 7,765
Deferred revenue	10,766	8,146
Accrued wages and payroll taxes	7,532	6,212
Income taxes payable	1,306	378
Other accrued expenses	4,201	3,688
Deferred compensation		2,424
Liabilities of discontinued operations	19	1,335
<b>Total current liabilities</b>	<b>30,147</b>	<b>29,948</b>
Deferred compensation	31	
Deferred revenue	83	97
Deferred income taxes	120	141
<b>Total liabilities</b>	<b>30,381</b>	<b>30,186</b>

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## Stockholders' equity

Common stock: \$.001 par value per share, 75,000 shares authorized; 39,474 and 39,205 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	39	39
Preferred stock: 500 shares authorized, none issued and outstanding at June 30, 2013 or December 31, 2012	0	0
Additional paid-in capital	75,574	74,965
Accumulated income	85,851	81,256
Accumulated other comprehensive income	(2,207)	60
Total stockholders' equity	159,257	156,320
<b>Total liabilities and stockholders' equity</b>	<b>\$ 189,638</b>	<b>\$ 186,506</b>

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****VASCO Data Security International, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(in thousands, except per share data)****(unaudited)**

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Revenue	\$ 37,260	\$ 46,642	\$ 72,626	\$ 78,900
Cost of goods sold	13,378	17,191	25,656	27,571
Gross profit	23,882	29,451	46,970	51,329
Operating costs:				
Sales and marketing	10,470	9,856	20,101	19,264
Research and development	5,345	4,796	10,192	9,497
General and administrative	5,492	5,330	10,944	10,405
Amortization of purchased intangible assets	651	472	1,093	951
Total operating costs	21,958	20,454	42,330	40,117
Operating income	1,924	8,997	4,640	11,212
Interest income, net	40	68	82	145
Other income, net	265	300	413	532
Income from continuing operations before income taxes	2,229	9,365	5,135	11,889
Provision for income taxes	379	1,967	873	2,497
Net income from continuing operations	1,850	7,398	4,262	9,392
Income (loss) from discontinued operations	(41)	(236)	333	(319)
Net income	\$ 1,809	\$ 7,162	\$ 4,595	\$ 9,073
Net income per share:				
Basic income (loss) per share				
Continuing	\$ 0.05	\$ 0.19	\$ 0.11	\$ 0.25
Discontinued	(0.00)	(0.01)	0.01	(0.01)
Total	\$ 0.05	\$ 0.18	\$ 0.12	\$ 0.24
Diluted income (loss) per share				
Continuing	\$ 0.05	\$ 0.19	\$ 0.11	\$ 0.24
Discontinued	(0.00)	(0.01)	0.01	(0.01)
Total	\$ 0.05	\$ 0.18	\$ 0.12	\$ 0.23
Weighted average common shares outstanding:				
Basic	38,908	38,065	38,798	37,928
Diluted	39,226	38,742	39,145	38,597

See accompanying notes to condensed consolidated financial statements.

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**VASCO Data Security International, Inc.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(in thousands)**

**(unaudited)**

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Net income	\$ 1,809	\$ 7,162	\$ 4,595	\$ 9,073
Other comprehensive income - Cumulative translation adjustment	(8)	(4,066)	(2,267)	(1,980)
Comprehensive income	\$ 1,801	\$ 3,096	\$ 2,328	\$ 7,093

See accompanying notes to condensed consolidated financial statements.



**Table of Contents****VASCO Data Security International, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

	Six months ended June 30,	
	2013	2012
Cash flows from operating activities:		
Net income from continuing operations	\$ 4,262	\$ 9,392
Adjustments to reconcile net income from continuing operations to net cash provided by continuing operations:		
Depreciation and amortization	1,951	1,848
Deferred tax expense (benefit)	(1,429)	1,052
Stock-based compensation	1,327	2,248
Changes in assets and liabilities net of acquisition:		
Accounts receivable, net	1,340	(3,003)
Inventories	(6,339)	(1,056)
Foreign sales tax receivable	(301)	244
Other current assets	(55)	(1,011)
Accounts payable	(1,429)	(2,745)
Income taxes payable	987	(1,929)
Accrued expenses	1,630	409
Current deferred compensation	(2,393)	(1,828)
Deferred revenue	2,068	(915)
Net cash provided by operating activities of continuing operations	1,619	2,708
Cash flows from investing activities of continuing operations:		
Purchase of Cronto	(19,495)	0
Additions to property and equipment	(273)	(524)
Additions to intangible assets	(88)	(123)
Other assets	321	184
Net cash used in investing activities of continuing operations	(19,535)	(463)
Cash flows from financing activities of continuing operations:		
Proceeds from exercise of stock options	19	97
Tax Payments for restricted stock issuances	(736)	0
Net cash provided by (used in) financing activities of continuing operations	(717)	97
Cash flows used in discontinued operations:		
Net cash provided by (used in) operating activities of discontinued operations	(473)	(620)
Net cash provided by (used in) discontinued operations	(473)	(620)
Effect of exchange rate changes on cash	(1,713)	(1,074)
Net increase in cash	(20,820)	648
Cash and equivalents, beginning of year	106,469	84,497
Cash and equivalents, end of period	\$ 85,649	\$ 85,145

See accompanying notes to condensed consolidated financial statements.



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### **VASCO Data Security International, Inc.**

#### **Notes to Condensed Consolidated Financial Statements**

**(All amounts are in thousands, except per share data)**

**(Unaudited)**

*Unless otherwise noted, references in this Quarterly Report on Form 10-Q to VASCO, company, we, our, and us, refer to VASCO Data Security International, Inc. and its subsidiaries.*

#### **Note 1 - Summary of Significant Accounting Policies**

##### **Nature of Operations**

VASCO Data Security International, Inc. and its wholly owned subsidiaries design, develop, market and support hardware and software security systems that manage and secure access to information assets. VASCO has operations in Austria, Australia, Belgium, Brazil, China, France, India, Japan, The Netherlands, Singapore, Switzerland, the United Arab Emirates, the United Kingdom, and the United States (U.S.).

##### **Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of VASCO Data Security International, Inc. and its subsidiaries and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the audited consolidated financial statements included in the company's Annual Report on Form 10-K for the year ended December 31, 2012.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements, and include all adjustments, consisting only of normal recurring adjustments, necessary for the fair presentation of the results of the interim periods presented. All significant intercompany accounts and transactions have been eliminated. The operating results for the interim periods presented are not necessarily indicative of the results expected for a full year.

##### **Principles of Consolidation**

The consolidated financial statements include the accounts of VASCO Data Security International, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

During 2011, our wholly-owned Dutch subsidiary, DigiNotar B.V., was declared bankrupt. The court-appointed trustee is responsible for the business activities, administration and liquidation of DigiNotar B.V. Accordingly, related assets, liabilities and activities are reflected in discontinued operations.

##### **Estimates and Assumptions**

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

##### **Foreign Currency Translation and Transactions**

The financial position and results of the operations of the majority of the company's foreign subsidiaries are measured using the local currency as the functional currency. Accordingly, assets and liabilities are translated into U.S. Dollars using current exchange rates as of the balance sheet date. Translation adjustments arising from differences in exchange rates are charged or credited to other comprehensive income. Revenue and expenses are translated at average exchange rates prevailing during the year. Gains and losses resulting from foreign currency transactions are included in the condensed consolidated statements of operations in other income (expense).

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The financial position and results of operations of our operations in Singapore and Switzerland are measured in U.S. Dollars. For these subsidiaries, gains and losses that result from foreign currency transactions are included in the consolidated statements of operations in other income (expense).

For the three and six months ended June 30, 2013, foreign currency transactions resulted in losses of \$0 and \$91, respectively, compared to losses of \$49 and gains of \$46 for the same period in 2012.

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### **Revenue Recognition**

We recognize revenue in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 985-605, *Software Revenue Recognition*, ASC 985-605-25, *Revenue Recognition Multiple Element Arrangements*, and Staff Accounting Bulletin 104.

Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

In multiple-element arrangements, some of our products are accounted for under the software provisions of ASC 985-605 and others under the provisions that relate to the sale of non-software products.

In our typical multiple-element arrangement, the primary deliverables include:

1. a client component (i.e., an item that is used by the person being authenticated in the form of either a new standalone hardware device or software that is downloaded onto a device the customer already owns),
2. host system software that is installed on the customer's systems (i.e., software on the host system that verifies the identity of the person being authenticated) or licenses for additional users on the host system software, if the host system software had been installed previously, and
3. post contract support (PCS) in the form of maintenance on the host system software or support.

Our multiple-element arrangements may also include other items that are usually delivered prior to the recognition of any revenue and incidental to the overall transaction, such as initialization of the hardware device, customization of the hardware device itself or the packaging in which it is delivered, deployment services where we deliver the device to our customer's end-use customer or employee and, in some limited cases, professional services to assist with the initial implementation of a new customer.

In multiple-element arrangements that include a hardware client device, we allocate the selling price among all elements, delivered and undelivered, based on our internal price lists and the percentage of the selling price of that element, per the price list, to the total of the estimated selling price of all of the elements per the price list. Our internal price lists for both delivered and undelivered elements were determined to be reasonable estimates of the selling price of each element based on a comparison of actual sales made to the price list for each item delivered and to vendor specific objective evidence (VSOE) for undelivered items.

Undelivered elements primarily are PCS. The method by which we determine VSOE has validated that the price lists are reasonable estimates of the selling price for PCS. The estimated selling price of PCS items is based on an established percentage of the user license fee attributable to the specific software and is applied consistently to all PCS arrangements. The percentage we use to establish VSOE, which is also generally consistent with the percentage used in the price list, is developed using the bell curve method. This method relies on historical data to show that at least 80% of renewals are within 15% of the median renewal percentage rate.

In multiple-element arrangements that include a software client device, we account for each element under the standards of ASC 985-605 related to software. When software client device and host software are delivered elements, we use the Residual Method (ASC 605-25) for determining the amount of revenue to recognize for token and software licenses if we have VSOE for all of the undelivered elements. Any discount provided to the customer is applied fully to the delivered elements in such an arrangement. VSOE of fair value of PCS agreements is based on customer renewal transactions for the initial two years on a worldwide basis. In sales arrangements where VSOE of fair value has not been established, revenue for all elements is deferred and amortized over the life of the arrangement.

For transactions other than multiple-element arrangements, we recognize revenue as follows:

- 1.

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*Hardware Revenue and License Fees:* Revenue from the sale of computer security hardware or the license of software is recorded upon shipment or, if an acceptance period is allowed, at the latter of shipment or customer acceptance. No significant obligations or contingencies exist with regard to delivery, customer acceptance or rights of return at the time revenue is recognized.

2. *Maintenance and Support Agreements:* Maintenance and support agreements generally call for us to provide software updates and technical support, respectively, to customers. Revenue on maintenance and technical support is deferred and recognized ratably over the term of the applicable maintenance and support agreement.
3. *Services:* Revenue is recognized ratably over the period in which the service is provided.
4. *Consulting and Education Services:* We provide consulting and education services to our customers. Revenue from such services is recognized during the period in which the services are performed.

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We recognize revenue from sales to distributors and resellers on the same basis as sales made directly to customers. We recognize revenue when there is persuasive evidence that an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection of the revenue is probable.

For large-volume transactions, we may negotiate a specific price that is based on the number of users of the software license or quantities of hardware supplied. The per unit prices for large-volume transactions are generally lower than transactions for smaller quantities and the price differences are commonly referred to as volume-purchase discounts.

All revenue is reported on a net basis, excluding any sales taxes or value added taxes.

## **Cash and Cash Equivalents**

Cash and cash equivalents are stated at cost plus accrued interest, which approximates fair value. Cash equivalents are high-quality short term money market instruments, with original maturities of three months or less. Cash and cash equivalents are held by a number of U.S. and non-U.S. commercial banks and money market investment funds.

## **Accounts Receivable and Allowance for Doubtful Accounts**

The credit-worthiness of customers (including distributors and resellers) is reviewed prior to shipment. A reasonable assurance of collection is a requirement for revenue recognition. Verification of credit and/or the establishment of credit limits are part of the customer contract administration process. Credit limit adjustments for existing customers may result from the periodic review of outstanding accounts receivable. The company records trade accounts receivable at invoice values, which are generally equal to fair value.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments for goods and services. We analyze accounts receivable balances, customer credit-worthiness, current economic trends and changes in our customer payment timing when evaluating the adequacy of the allowance for doubtful accounts. The allowance is based on a specific review of all significant past-due accounts. If the financial condition of our customers deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

## **Inventories**

Inventories, consisting principally of hardware and component parts, are stated at the lower of cost or market. Cost is determined using the first-in-first-out (FIFO) method. We write down inventory when it appears that the carrying cost of the inventory may not be recovered through subsequent sale of the inventory. The company analyzes the quantity of inventory on hand, the quantity sold in the past year, the anticipated sales volume in the form of sales to new customers as well as sales to previous customers, the expected sales price and the cost of making the sale when evaluating the valuation of our inventory. If the sales volume or sales price of a specific model declines significantly, additional write downs may be required.

## **Property and Equipment**

Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets ranging from three to seven years. Additions and improvements are capitalized, while expenditures for maintenance and repairs are charged to operations as incurred. Gains or losses resulting from sales, disposals, or retirements are recorded as incurred, at which time related costs and accumulated depreciation are removed from the accounts.

## **Goodwill and Other Intangibles**

We account for goodwill and indefinite-lived intangible assets in accordance with ASC Topic 350-20, *Goodwill and Other*. Indefinite-lived intangible assets include proprietary technology, patents, trademarks and other intangible assets. Intangible assets other than patents with definite lives are amortized over the useful life, generally three to seven years for proprietary technology. Patents are amortized over the life of the patent, generally 20 years in the U.S.

We assess the impairment of goodwill and intangible assets with indefinite lives each year-end or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important which could trigger an impairment review include significant underperformance relative to expected historical or projected future operating results, significant changes in the manner of our use of

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the acquired assets or the strategy for our overall business, and significant negative industry or economic trends. Once identified, the amount of the impairment is computed by comparing carrying value of the assets to fair value. Fair value for goodwill and intangible assets is determined using our stock price which is a level 1 valuation, as defined in ASC 820-10, *Fair Value Measurements and Disclosures*.

### **Research and Development Costs**

Costs for research and development, principally the design and development of hardware, and the design and development of software prior to the determination of technological feasibility, are expensed as incurred on a project-by-project basis.



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### **Software Development Costs**

We capitalize software development costs in accordance with ASC 985-20, *Costs of Software to be Sold, Leased, or Marketed*. Research costs and software development costs, prior to the establishment of technological feasibility, determined based upon the creation of a working model, are expensed as incurred. Our software capitalization policy defines technological feasibility as a functioning beta test prototype with confirmed manufacturability (a working model), within a reasonably predictable range of costs. Additional criteria include receptive customers, or potential customers, as evidenced by interest expressed in a beta test prototype, at some suggested selling price. Our policy is to amortize capitalized costs by the greater of (a) the ratio that current gross revenue for a product bears to the total of current and anticipated future gross revenue for that product or (b) the straight-line method over the remaining estimated economic life of the product, generally two to five years, including the period being reported on. No software development costs were capitalized during the three and six months ended June 30, 2013.

### **Income Taxes**

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. We measure deferred tax assets and liabilities 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. We recognize the effect of a change in tax rates on deferred tax assets and liabilities in income in the period that includes the enactment date.

We monitor our potential income tax exposures as required by ASC 740-10, *Income Taxes*.

We have significant net operating loss carryforwards in the U.S. and other countries which are available to reduce the liability on future taxable income. A valuation reserve has been provided to offset some of these future benefits because we have not determined that their realization is more likely than not.

### **Fair Value of Financial Instruments**

At June 30, 2013 and December 31, 2012, our financial instruments were cash equivalents, accounts receivable, accounts payable and accrued liabilities. The estimated fair value of our financial instruments has been determined using level one inputs as defined in ASC 820, *Fair Value Measurements and Disclosures*. The fair values of the financial instruments were not materially different from their carrying amounts at June 30, 2013 and December 31, 2012.

### **Accounting for Leases**

All of our leases are operating leases. Rent expense on facility leases is charged evenly over the life of the lease, regardless of the timing of actual payments.

### **Stock-Based Compensation**

We have stock-based employee compensation plans, described in Note 10. ASC 718-10, *Stock Compensation* requires us to estimate the fair value of restricted stock granted to employees, directors and others and to record compensation expense equal to the estimated fair value. Compensation expense is recorded on a straight-line basis over the vesting period.

### **Warranty**

Warranties are provided on the sale of certain of our products and an accrual for estimated future claims is recorded at the time revenue is recognized. We estimate the cost based on past claims experience, sales history and other considerations. We regularly assess the adequacy of our estimates and adjust the amounts as necessary. Our standard practice is to provide a warranty on our hardware products for either a one or two year period after the date of purchase. Customers may purchase extended warranties covering periods from one to four years after the standard warranty period. We defer the revenue associated with the extended warranty and recognize it into income on a straight-line basis over the extended warranty period. We have historically experienced minimal actual claims over the warranty period.

**Table of Contents****Note 2 - Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable represents the balance due on credit sales made to customers. The allowance for doubtful accounts is an estimate of losses that may result from customers' inability to make payment on their outstanding balances.

	June 30, 2013	December 31, 2012
Accounts receivable	\$ 26,624	\$ 29,468
Allowance for doubtful accounts	(663)	(1,894)
Accounts receivable, net	\$ 25,961	\$ 27,574

**Note 3 - Inventories**

Inventories, consisting principally of hardware and component parts, are stated at the lower of cost or market. Cost is determined using the FIFO method.

Inventories are comprised of the following:

	June 30, 2013	December 31, 2012
Component parts	\$ 14,518	\$ 6,613
Work-in-process and finished goods	10,970	12,062
Total	\$ 25,488	\$ 18,675

**Note 4 Discontinued Operations**

During 2011, our wholly-owned Dutch subsidiary, DigiNotar B.V., was declared bankrupt. The court-appointed trustee is responsible for the business activities, administration and liquidation of DigiNotar B.V. Accordingly, related assets, liabilities and activities are reflected in discontinued operations.

Income (loss) from discontinued operations, net of tax, for the three and six months ended June 30, 2013 was \$(41) and \$333, respectively and \$(236) and \$(319) for the same periods in 2012.

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At June 30, 2013 and December 31, 2012, assets of discontinued operations and liabilities of discontinued operations consist of the following:

	June 30, 2013	December 31, 2012
Contingent consideration due from escrow	\$ 1,822	\$ 1,851
Due from DigiNotar net of allowance for doubtful account of \$952		423
Income taxes receivable	291	377
 Assets of discontinued operations	 \$ 2,113	 \$ 2,651
Due to DigiNotar	\$	\$ 1,301
Accrued professional fees	19	34
 Liabilities of discontinued operations	 \$ 19	 \$ 1,335

## Note 5 Acquisition of Cronto

To further increase our product offerings, on May 20, 2013, we acquired all of the stock of Cronto Limited, a private company organized and existing in the United Kingdom ( Cronto ), for initial consideration of EUR 15,000 (\$19,611 at the exchange rate of 1.31 US Dollars per Euro). The purchase price was subject to verification of certain balances resulting in an additional payment of GBP 358 in June 2013 (approximately \$555 at an exchange rate of 1.55 US Dollars per British Pound).

Consideration was allocated to assets acquired and liabilities assumed based on their respective fair values as of the acquisition date as follows:

Cash	\$ 672
Inventory	486
Other current assets	116
Property and equipment	16
Goodwill	9,203
Intangible assets	13,244
Customer deposits	(585)
Deferred income tax liabilities	(2,796)
Other current liabilities	(190)
	 \$ 20,166

In addition to consideration detailed above, the transaction also includes contingent consideration of 2,000 (\$2,620 at the exchange rate of 1.31 US Dollars per Euro) subject to orders for Cronto products during the twenty-four months ended May 20, 2015 to be recorded as earned.

Cash paid at closing of 15,000 was funded by our existing cash balances.

Acquired identifiable intangible assets totaling \$13,244 are being amortized over their respective useful lives ranging from two to five years. Goodwill is attributable to expected increased revenues and reduced costs resulting from synergies of combined operations.

The acquisition is not material to our consolidated balance sheet and results of operations. The consolidated financial statements include the operating results of Cronto from the acquisition date.

**Table of Contents****Note 6 Goodwill**

Goodwill activity for the six months ended June 30, 2013 consisted of the following:

Net balance at December 31, 2012	\$ 13,176
Additions - Cronto	9,203
Net foreign currency translation	(378)
Net balance at June 30, 2013	\$ 22,001

Additions-Cronto refers to goodwill related to the acquisition of Cronto described above.

Certain portions of goodwill are denominated in local currencies and are subject to currency fluctuations.

**Note 7 Intangible Assets**

Intangible asset activity for the six months ended June 30, 2013 is detailed in the following table.

	Capitalized Technology	Patents & Trademarks	Other	Total Intangible Assets
Net balance at December 31, 2012	\$ 4,847	\$ 1,642	\$ 18	\$ 6,507
Additions - Cronto	11,924	222	1,098	13,244
Additions - Other	0	95	0	95
Net foreign currency translation	0	(4)	(21)	(25)
Amortization expense	(1,018)	(45)	(29)	(1,092)
Net balance at June 30, 2013	\$ 15,753	\$ 1,910	\$ 1,066	\$ 18,729
June 30, 2013 balance at cost	\$ 29,234	\$ 2,136	\$ 1,130	32,500
Accumulated amortization	(13,481)	(226)	(64)	(13,771)
Net balance at June 30, 2013	\$ 15,753	\$ 1,910	\$ 1,066	\$ 18,729

Additions-Cronto refers to intangibles acquired in the acquisition of Cronto described above including capitalized technology, trademarks, customer relationships and non-compete agreements.

Certain intangible assets are denominated in local currencies and are subject to currency fluctuations.

**Note 8 Income Taxes**

Our effective tax rate for the six months ended June 30, 2013 is equal to our expected annual tax rate of 17%. This is lower than the U.S. statutory rate of 34%, primarily due to income in foreign jurisdictions taxed at lower rates. In the first quarter of 2013, our expected annual tax rate was also estimated to be 17%.

Our effective tax rate for the six months ended June 30, 2012 was equal to our expected annual tax rate of 21%. The expected annual rate was lower than the U.S. statutory rate primarily due to income in foreign jurisdictions taxed at lower rates. In the first quarter of 2012, our estimated annual tax rate was 21%.

At December 31, 2012, we had \$11,620 of U.S. net operating loss ( NOL ) carryforwards, of which \$9,093 represents U.S. tax deductions for employee stock option gains, the tax benefit of which will be credited to additional paid in capital when the NOL carryforwards are utilized. The

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U.S. loss carryforwards expire in varying amounts beginning in 2022 and continuing through 2032. If certain substantial changes in the company's ownership were deemed to have occurred, there would be an annual limitation on the amount of the U.S. NOL carryforwards that could be utilized.

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At December 31, 2012, we had foreign NOL carryforwards of \$5,279 and other foreign deductible carryforwards of \$3,491. The foreign NOL carryforwards have no expiration dates and the other deductible carryforwards expire from 2016 to 2019. At December 31, 2012, we had a valuation allowance of \$2,284 for certain foreign deferred tax assets.

**Note 9 Warranties**

We maintain a reserve for potential warranty claims related to products sold and recognized in revenue. We regularly reassess the adequacy of our estimates and adjust the amounts as necessary. Our warranty reserve is included in other accrued expenses.

The activity in our warranty liability was as follows:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Balance, beginning of period	\$ 46	\$ 96	\$ 45	36
Provision for claims	35	18	66	98
Product or cash issued to settle claims	(47)	(26)	(77)	(46)
Balance, end of period	\$ 34	\$ 88	\$ 34	\$ 88

At June 30, 2013, deferred revenue from extended warranties was \$93.

**Note 10 Long-Term Incentive Compensation and Stock Based Compensation**

Under the VASCO Data Security International, Inc. 2009 Equity Incentive Plan ( 2009 Equity Incentive Plan ), we awarded 266 shares of restricted stock in the first quarter of 2013 consisting of 122 unissued shares subject to future performance criteria and 144 issued shares. The market value of the 144 issued restricted shares of \$1,096 at the date of grant is being amortized over the respective vesting periods of one to four years. The market value of the 122 unissued shares subject to performance criteria of \$931 at the date of grant was amortized over the four-year vesting period beginning in the first quarter of 2013. During the second quarter of 2013, achievement of the performance targets was deemed improbable and prior provisions of \$54, recorded in the first quarter, were reversed.

During the second quarter of 2013, long term incentive awards were granted to key employees, other than named executive officers. The awards are designated in U.S. Dollars. Time-based awards of \$694, vest annually over a four-year period, and are recorded ratably as compensation expense over the four year vesting period. Performance-based awards of \$2,082 are subject to performance criteria established by the Board of Directors. During the second quarter, achievement of the performance targets was deemed improbable. Accordingly, no provision has been recorded for the performance-based awards.

The following table details long-term compensation plan and stock-based compensation expense for the three and six months ended June 30, 2013 and 2012:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Restricted stock	\$ 573	\$ 845	\$ 1,327	\$ 1,694
Long-term compensation plan	31	325	31	554
Total expense	\$ 604	\$ 1,170	\$ 1,358	\$ 2,248

**Note 11 Common Stock and Earnings per Share**

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Under with the 2009 Equity Incentive Plan, during the three months ended March 31, 2013, we issued 144 shares of restricted common stock for awards granted in the first quarter of 2013 and 134 shares of unrestricted common stock related to performance awards granted in prior years.

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Basic earnings per share is based on the weighted average number of shares outstanding and excludes the dilutive effect of unexercised common stock equivalents. Diluted earnings per share is based on the weighted average number of shares outstanding and includes the dilutive effect of unexercised common stock equivalents to the extent they are not anti-dilutive. The details of the earnings per share calculations for the three and six months ended June 30, 2013 and 2012 follow:

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Net income - continuing operations	\$ 1,850	\$ 7,398	\$ 4,262	\$ 9,392
Net income (loss) - discontinued operations	(41)	(236)	333	(319)
Net income	\$ 1,809	\$ 7,162	\$ 4,595	\$ 9,073
Weighted average common shares outstanding				
Basic	38,908	38,065	38,798	37,928
Incremental shares with dilutive effect:				
Stock options	199	524	199	530
Restricted stock awards	118	153	148	139
Diluted	39,226	38,742	39,145	38,597
Basic income (loss) per share				
Continuing operations	\$ 0.05	\$ 0.19	\$ 0.11	\$ 0.25
Discontinued operations	(0.00)	(0.01)	0.01	(0.01)
Total net income per share	\$ 0.05	\$ 0.18	\$ 0.12	\$ 0.24
Diluted income (loss) per share				
Continuing operations	\$ 0.05	\$ 0.19	\$ 0.11	\$ 0.24
Discontinued operations	(0.00)	(0.01)	0.01	(0.01)
Total net income per share	\$ 0.05	\$ 0.18	\$ 0.12	\$ 0.23



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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (in thousands, except headcount, ratios, time periods and percents)**

*Unless otherwise noted, references in this Quarterly Report on Form 10-Q to VASCO, company, we, our, and us refer to VASCO Data Security International, Inc. and its subsidiaries.*

#### **Cautionary Note Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q, including Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk, contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended and Section 27A of the Securities Act of 1933, as amended concerning, among other things, our expectations regarding the prospects of, and developments and business strategies for, VASCO and our operations, including the development and marketing of certain new products and services and the anticipated future growth in certain markets in which we currently market and sell our products and services or anticipate selling and marketing our products or services in the future. These forward-looking statements (1) are identified by use of terms and phrases such as expect, believe, will, anticipate, emerging, intend, plan, could, may, estimate, goal, possible, potential and similar words and expressions, but such words and phrases are not the exclusive means of identifying them, and (2) are subject to risks and uncertainties and represent our present expectations or beliefs concerning future events. VASCO cautions that the forward-looking statements are qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements. These risks, uncertainties and other factors have been described in greater detail in our Annual Report on Form 10-K for the year ended December 31, 2012 and include, but are not limited to, (a) risks of general market conditions, including currency fluctuations and the uncertainties resulting from turmoil in world economic and financial markets, (b) risks inherent to the computer and network security industry, including rapidly changing technology, evolving industry standards, increasingly sophisticated hacking attempts, increasing numbers of patent infringement claims, changes in customer requirements, price competitive bidding, and changing government regulations, and (c) risks specific to VASCO, including, demand for our products and services, competition from more established firms and others, pressures on price levels and our historical dependence on relatively few products, certain suppliers and certain key customers. Thus, the results that we actually achieve may differ materially from any anticipated results included in, or implied by these statements. Except for our ongoing obligations to disclose material information as required by the U.S. federal securities laws, we do not have any obligations or intention to release publicly any revisions to any forward-looking statements to reflect events or circumstances in the future or to reflect the occurrence of unanticipated events.

#### **General**

The following discussion is based upon our consolidated results of operations for the quarters and six months ended June 30, 2013 and 2012 (percentages in the discussion, except for returns on average net cash balances, are rounded to the closest full percentage point) and should be read in conjunction with our consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

We design, develop, market and support open standards-based hardware and software security systems that manage and secure access to information assets. We also design, develop, market and support patented strong user authentication products and services for e-business and e-commerce. Our products enable secure financial transactions to be made over private enterprise networks and public networks, such as the Internet. Our strong user authentication is delivered via our hardware and software DIGIPASS security products (collectively DIGIPASSES), many of which incorporate an electronic and digital signature capability, which further protects the integrity of electronic transactions and data transmissions. Some of our DIGIPASSES are compliant with the Europay MasterCard Visa (EMV) standard and are compatible with MasterCard's and VISA's Chip Authentication Program (CAP). Some of our DIGIPASSES comply with the Initiative for Open Authentication (OATH). As evidenced by our current customer base, most of our products are purchased by companies and, depending on the business application, are distributed to either their employees or their customers. Those customers may be other businesses or, as an example in the case of Internet banking, our customer banks' corporate and retail customers. In future years, we expect that our customers will increasingly use our cloud-based service offering, DIGIPASS as a Service (DPS) or MYDIGIPASS.COM (MDPC) or together (DPS/MDPC) as described below.

Our target market is any business process that uses some form of electronic interface, particularly the Internet, where the owner of that process is at risk if unauthorized users can gain access to its process and either obtain proprietary information or execute transactions that are not authorized. Our products can not only increase the security associated with accessing the business process, thereby reducing the losses from unauthorized access, but also, in many cases, can reduce the cost of the process itself by automating activities that were previously performed manually.

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We offer our products either through: (a) a product sales and licensing model; or (b) through our services platform, which includes both our DPS product offering, which was first made available in the fourth quarter of 2010, and our MDPC product offering, which was introduced in April 2012. DPS/MDPC is our cloud-based authentication platform. Our product license and sales model is expected to be used in situations where the application owner wants to control all of the critical aspects of the authentication process. We expect that our services platform will be used by: (a) companies lacking technical resources or expertise to implement a full authentication process or preferring to focus their primary attention on other aspects of their business rather than on the authentication process or (b) consumers that are aware of the dangers posed by identity theft.

By using our DPS authentication platform, business customers can deploy two-factor authentication more quickly, incur less upfront costs and be able to use strong authentication when logging onto a larger number of internet sites and applications. We expect those applications using DPS to include B2B applications and B2E applications (e.g., employees of companies logging into third party applications operated in the cloud). We believe that corporations or application service providers will pay us a fee based on either the number of users accessing their application through our platform or the number of authentication clicks consumed by their users when accessing their application.

By using our MDPC platform, consumers using B2C applications will have convenient access to those applications with increased security. We expect that we will earn commissions from various vendors for purchases made by consumers using our platform.

While there were minimal revenues generated from the services platform to date, we expect that DPS/MDPC will start making a contribution in 2014. We believe that DPS/MDPC has the potential for significant future growth as it will make two-factor authentication more affordable and readily available to users and application markets.

### **Comparison of Results for the Three and Six Months Ended June 30, 2013 and 2012**

*Industry Growth:* We do not believe that there are any accurate measurements of the total industry's size or the industry's growth rate. We believe, however, that the industry using our product sales and licensing model will grow at a significant rate as the use of the internet increases and the awareness of the risks of using the internet become more prevalent among application owners. We also believe that a market will develop for our cloud-based service offering and grow at a significant rate as business owners and consumers become more aware of the risks involved in conducting business over the internet. We expect that growth will be driven by new government regulations, growing awareness of the impact of identity theft, and the growth in commerce that is transacted electronically. The issues driving the growth are global issues and the rate of adoption in each country is a function of that country's culture, the competitive position of businesses operating in that country, the country's overall economic conditions and the degree to which businesses and consumers within the country use technology.

*Economic Conditions:* Our revenue may vary significantly with changes in the economic conditions in the countries in which we currently sell products. With our current concentration of revenue in Europe and specifically in the banking/finance vertical market, significant changes in the economic outlook for the European banking market may have a significant effect on our revenue.

There continues to be significant global economic uncertainty, including Europe, our most important market. While it appears that circumstances that led to the sovereign debt crisis abated in 2012, many significant economic issues have not been addressed fully. As a result, we expect that Europe will continue to face difficult economic conditions in 2013. We believe that the current economic conditions in Europe may limit our growth opportunities in the Enterprise and Application Security market, but do not expect that the economic conditions will have a significant impact on the Banking market. Should the sovereign debt issue escalate, especially to the point that a country defaults on its debt or the European Union, or Euro Monetary Union, either disbands or is re-formulated, we expect that the resulting economic difficulties would have a major negative impact on the global economy, not just the economies of Western Europe, and our business.

*Cybersecurity:* Our use of technology is increasing and is critical in three primary areas of our business:

1. Software and information systems that we use to help us run our business more efficiently and cost effectively;
2. The products we have traditionally sold and continue to sell to our customers for integration into their software applications contain technology that incorporates the use of secret numbers and encryption technology; and
- 3.

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New products and services that we are introducing to the market, such as DPS/MDPC, are focused on processing information through our servers (or in the cloud from our customers' perspective).

We believe that the risks and consequences of potential incidents in each of the above areas are different.

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In the case of the information systems we use to help us run our business, we believe that an incident could disrupt our ability to take orders or deliver product to our customers, but such a delay in these activities would not have a material impact on our overall results. To minimize this risk, we actively use various forms of security and monitor the use of our systems regularly to detect potential incidents as soon as possible.

In the case of products that we have traditionally sold, we believe that the risk of a potential cyber incident is minimal. We offer our customers the ability to either create the secret numbers themselves or have us create the numbers on their behalf. When asked to create the numbers, we do so in a secure environment with limited physical access and store the numbers on a system that is not connected to any other network, including other VASCO networks, and similarly, is not connected to the internet. In the case of our new products and services, which involve the active daily processing of the secret numbers on our servers or servers managed by others in a hosted environment, we believe a cyber incident could have a material impact on our future business. We also believe that these products may be more susceptible to cyber attacks than our traditional products since it involves the active processing of transactions using the secret numbers. While we do not have a significant amount of revenue from these products today, we believe that these products have the potential to provide substantial future growth. A cyber incident involving these products in the future could substantially impair our ability to grow the business and we could suffer significant monetary and other losses and significant reputational harm.

To minimize the risk, we review our security procedures on a regular basis. Our reviews include the processes and software programs we are currently using as well as new forms of cyber incidents and new or updated software programs that may be available in the market that would help mitigate the risk of incidents. While we do not insure against cyber incidents today, we would likely review insurance policies related to our new product offering in the future. Overall, we expect the cost of securing our networks will increase in future periods, whether through increased staff, systems or insurance coverage.

*Income Taxes:* Our effective tax rate reflects our global structure related to the ownership of our intellectual property ( IP ). All our IP is owned by two subsidiaries, one in the U.S. and one in Switzerland. These two subsidiaries have entered into agreements with most of the other VASCO entities under which those other entities provide services to our U.S. and Swiss subsidiaries on either a percentage of revenue or on a cost plus basis or both. Under this structure, the earnings of our service provider subsidiaries are relatively constant. These service provider companies tend to be in jurisdictions with higher effective tax rates. Fluctuations in earnings tend to flow to the U.S. and Swiss companies. Earnings flowing to the U.S. company are expected to be taxed at a rate of 35% to 40%, while earnings flowing to the Swiss company are expected to be taxed at a rate ranging from 8% to 12%.

With the majority of our revenues being generated outside of the U.S., our consolidated effective tax rate is strongly influenced by the effective tax rate of our foreign operations. Changes in the effective rate related to foreign operations reflect changes in the geographic mix of where the earnings are realized and the tax rates in each of the countries in which it is earned. The statutory tax rate for the primary foreign tax jurisdictions ranges from 8% to 35%.

The geographic mix of earnings of our foreign subsidiaries will primarily depend on the level of our service provider subsidiaries' pretax income, which is recorded as an expense by the U.S. and Swiss subsidiaries that own the IP and the benefit that is realized in Switzerland through the sales of product. The level of pretax income in our service provider subsidiaries is expected to vary based on:

1. the staff, programs and services offered on a yearly basis by the various subsidiaries as determined by management, or
2. the changes in exchange rates related to the currencies in the service provider subsidiaries, or
3. the amount of revenues that the service provider subsidiaries generate.

For items 1 and 2 above, there is a direct impact in the opposite direction on earnings of the U.S. and Swiss entities. Any change from item 3 is generally expected to result in a larger change in income in the U.S. and Swiss entities in the direction of the change (increased revenues expected to result in increased margins/pretax profits and conversely decreased revenues expected to result in decreased margins/pretax profits).

In addition to the provision of services, the intercompany agreements transfer the majority of the business risk to our U.S. and Swiss subsidiaries. As a result, the pretax income of the contracting subsidiaries providing services is reasonably assured while the pretax income of the U.S. and Swiss subsidiaries varies directly with our overall success in the market.

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For 2013, we expect that our tax rate will be lower than in 2012 as growth in earnings of the Swiss company are expected to exceed the growth in earnings of the U.S. company, in part due to the fact that the final buy-in payments related to the original purchase of the IP were completed in 2012 (i.e., taxable income will decrease in the higher tax rate jurisdictions and increase in the lower tax rate jurisdictions as the Swiss and U.S. subsidiaries no longer make payments to the higher rate foreign countries related to the original purchase of the IP). The actual tax rate for 2013, however, will be determined based on the geographic location of earnings in 2013.

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**Currency Fluctuations:** In the second quarter of 2013 and 2012 approximately 92% and 94%, respectively, of our revenue was generated outside the United States. For the six months ended June 30, 2013 and 2012 approximately 92% and 93%, respectively, of our revenue was generated outside of the U.S.

In addition, in the second quarter of 2013 and 2012 approximately 82% and 80%, respectively, of our operating expenses were incurred outside the United States. For the six months ended June 30, 2013 and 2012 approximately 81% and 79%, respectively, of our operating expenses were incurred outside of the U.S. As a result, changes in currency exchange rates, especially from the Euro to U.S. Dollar, can have a significant impact on revenue and expenses.

In general, to minimize the net impact of currency fluctuations on operating income, we attempt to denominate an amount of billings in a currency such that it would provide a hedge against the operating expenses being incurred in that currency. We expect that changes in currency rates may also impact our future results if we are unable to match amounts of revenue with our operating expenses in the same currency. If the amount our revenue in Europe denominated in Euros continues as it is now or declines, we do not expect that we will be able to balance fully the exposures of currency exchange rates on revenue and operating expenses.

The U.S. Dollar to Euro exchange rate was essentially unchanged for the quarter and six months ended June 30, 2013, respectively, compared to the same periods in 2012. In addition, the U.S. Dollar strengthened approximately 1% against the Australian Dollar for the quarter and six months ended June 30, 2013, respectively, compared to the same periods in 2012. As a result, the changes in exchanges rates did not have a significant impact on either revenues or operating expenses for the quarter or six months ended June 30, 2013.

The financial position and the results of operations of most of our foreign subsidiaries, with the exception of our subsidiaries in Switzerland and Singapore, are measured using the local currency as the functional currency. Accordingly, assets and liabilities are translated into U.S. Dollars using current exchange rates as of the balance sheet date. Revenues and expenses are translated at average exchange rates prevailing during the period. Translation adjustments arising from differences in exchange rates generated other comprehensive loss of \$8 in the second quarter of 2013 and \$2,267 for the first six months of 2013. Translation adjustments arising from differences in exchange rates generated other comprehensive loss of \$4,066 in the second quarter of 2012 and \$1,980 for the first six months of 2012. These amounts are included as a separate component of stockholders' equity. The functional currency for our subsidiaries in Switzerland and Singapore is the U.S. Dollar.

Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations in other non-operating income (expense). Foreign exchange transaction losses were \$0 and \$91 in the second quarter and first six months of 2013, respectively, compared to losses of \$49 and gains of \$46 in the second quarter and first six months of 2012, respectively.

## **Revenue**

*Revenue by Geographic Regions:* We classify our sales by customers' location in four geographic regions: 1) EMEA, which includes Europe, the Middle East and Africa; 2) the United States, which for our purposes includes sales in Canada; 3) Asia Pacific Rim; and 4) Other Countries, including Australia, Latin America and India. The breakdown of revenue in each of our major geographic areas was as follows:

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	EMEA	United States	Asia Pacific	Other Countries	Total
<b>Three months ended June 30:</b>					
Revenue:					
2013	\$ 24,460	\$ 2,904	\$ 6,670	\$ 3,226	\$ 37,260
2012	31,367	2,914	8,815	3,546	46,642
Percent of Total:					
2013	65%	8%	18%	9%	100%
2012	67%	6%	19%	8%	100%
<b>Six months ended June 30:</b>					
Revenue:					
2013	\$ 46,478	\$ 5,930	\$ 11,356	\$ 8,862	\$ 72,626
2012	50,744	5,840	15,367	6,949	78,900
Percent of Total:					
2013	64%	8%	16%	12%	100%
2012	64%	7%	20%	9%	100%

Total revenue in the second quarter of 2013 decreased \$9,382, or 20%, from the second quarter of 2012. The decrease was primarily attributable to a 21% decrease in revenues from the Banking market and an 18% decrease in revenues from the Enterprise and Application Security market. For the first six months of 2013, total revenue decreased \$6,274 or 8% from the first six months of 2012. The decrease was primarily attributable to a 5% decrease in revenues from the Banking market and a 19% decrease in revenues from the Enterprise and Application security market.

Revenue generated in EMEA during the second quarter of 2013 was \$6,907, or 22%, lower than the second quarter of 2012. For the first six months, revenue generated in EMEA was \$4,266, or 8% lower than the first six months of 2012. The decrease in revenues in both the second quarter and first six months of 2013 compared to the same periods in 2012 reflected a decrease in revenues from both the Banking and the Enterprise and Application Security markets.

Revenue generated in the United States for both the second quarter and first six months of 2013 was largely unchanged from the second quarter and first six months of 2012. Revenues for both the second quarter and first six months of 2013 compared to both periods in 2012 reflected an increase in revenues from the Banking market offset by a decline in revenue from the Enterprise and Application Security market. Given the size of the market, our results may vary significantly period to period based on the size and timing of shipment of individual orders.

Revenue generated in the Asia Pacific region during the second quarter of 2013 was \$2,145, or 24%, lower than the second quarter of 2012. For the first six months of 2013 revenue was \$4,011, or 26% lower than the first six months of 2012. The decrease in revenues reflected a decline in revenue from both the banking and the enterprise and application security markets in both periods.

Revenue generated from Other Countries during the second quarter of 2013 was \$320, or 9%, lower than the second quarter of 2012. For the first six months of 2013 revenue was \$1,913, or 28% higher than the first six months of 2012. The decrease in revenues from Other Countries in the second quarter of 2013 compared to 2012 was primarily due to a decrease in revenues from both the Banking and the Enterprise and Application Security markets in Australia. The increase in revenues from Other Countries for the first six months of 2013 compared to 2012 was primarily due to an increase in revenues from the Banking markets in Australia, India and South America partially offset by a decrease in revenues from the Enterprise and Application Security markets in Australia and India. We expect that revenues from Other Countries will be more volatile than from our other regions given their earlier stage of development of the authentication market in those countries. VASCO, however, plans to continue to invest in new markets based on our estimates of the each market's demand for strong user authentication.

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*Revenue by Target Market:* Revenue is generated currently from two primary markets, banking/finance (Banking) and enterprise and application security, through the use of both direct and indirect sales channels. The Enterprise and Application Security market includes products used by employees of corporations to secure their internal networks (i.e., enterprise security market) and business-to-business, business-to-consumer, e-commerce, e-government, e-gaming and other vertical applications (i.e., the application security market) that are not related to banking or finance. In addition, revenue from services-related activities, such as maintenance and support are included in the Enterprise and Application Security markets. Management currently views the Enterprise and Application Security market as one market because the same products are sold through the same channels to both customer groups. Sales to the Enterprise Security and Application market are generally for smaller quantities and higher prices than sales made to the banking market. The breakdown of revenue between the two primary markets was as follows:

	Banking	Enterprise & Application Security	Total
<b>Three months ended June 30:</b>			
Revenue:			
2013	\$ 30,827	\$ 6,433	\$ 37,260
2012	38,836	7,806	46,642
Percent of Total:			
2013	83%	17%	100%
2012	83%	17%	100%
<b>Six months ended June 30:</b>			
Revenue:			
2013	\$ 60,267	\$ 12,359	\$ 72,626
2012	63,576	15,324	78,900
Percent of Total:			
2013	83%	17%	100%
2012	81%	19%	100%

Revenue in the second quarter of 2013 from the Banking market decreased \$8,009, or 21%, from the second quarter of 2012 and revenue from the Enterprise and Application Security market decreased \$1,373, or 18%, in the same period. Revenue for the first six months of 2013 from the Banking market decreased \$3,309, or 5%, compared to the first six months of 2012, while revenue from the Enterprise and Application Security market decreased \$2,965 or 19% in the same period.

The decrease in revenues from the Banking market in the second quarter and first six months of 2013 compared to the same periods of 2012 reflected a decline in revenues from hardware products sold partially offset by an increase in revenues from non-hardware products.

Revenues from the Banking market in the second quarter of 2013 compared to the same periods of 2012 decreased in all regions other than the United States. For the first six months of 2013 compared to the same period of 2012, decreases in revenues from the Banking markets in EMEA and Asia Pacific regions were partially offset by increases in revenues from the Banking markets in United States and Other Countries regions. While we believe that the global banking market is relatively stable, our revenues may vary significantly period to period and region to region based on the size and timing of shipment of individual orders.

The decrease in revenues from the Enterprise and Application Security market in the second quarter and first six months of 2013 compared to the comparable periods of 2012 reflected a decline in revenues from both hardware products and from non-hardware products sold.

Revenues in the Enterprise and Application Security market decreased in all of our geographic areas for both the second quarter and first six months of 2013 compared to the comparable periods in 2012.



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The size of the Enterprise and Application Security market in all regions other than EMEA is relatively small and, as a result, our revenues may vary significantly period to period based on the size and timing of shipment of individual orders.

**Gross Profit and Operating Expenses**

The following table sets forth, for the periods indicated, certain consolidated financial data as a percentage of revenue from continuing operations for the three months and six months ended June 30, 2013 and 2012:

**AS A PERCENTAGE OF REVENUE**

	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	35.9%	36.9%	35.3%	35.0%
Gross profit	64.1%	63.1%	64.7%	65.0%
Operating costs:				
Sales and marketing	28.1%	21.1%	27.7%	24.4%
Research and development	14.3%	10.3%	14.0%	12.0%
General and administrative	14.7%	11.4%	15.1%	13.2%
Amortization of purchased intangible assets	1.8%	1.0%	1.5%	1.2%
Total operating costs	58.9%	43.8%	58.3%	50.8%
Operating income	5.2%	19.3%	6.4%	14.2%
Interest income	0.1%	0.2%	0.1%	0.2%
Other income (expense)	0.7%	0.6%	0.6%	0.7%
Income from continuing operations before income taxes	6.0%	20.1%	7.1%	15.1%
Provision for income taxes	1.0%	4.2%	1.2%	3.2%
Net income from continuing operations	5.0%	15.9%	5.9%	11.9%

**Gross Profit**

Consolidated gross profit for the quarter ended June 30, 2013 was \$23,882, a decrease of \$5,569, or 19%, from the quarter ended June 30, 2012. Gross profit as a percentage of revenue (gross profit margin) was 64% for the quarter ended June 30, 2013, as compared to 63% for the quarter ended June 30, 2012. The increase in gross profit as a percentage of revenue for the second quarter of 2013 compared to 2012 primarily reflects an increase in non-hardware revenues as a percentage of total revenue.

Consolidated gross profit for the six months ended June 30, 2013 was \$46,970, a decrease of \$4,359, or 8%, from the comparable period in 2012. Gross profit as a percentage of revenue (gross profit margin) was 65% for both the six months ended June 30, 2013 and 2012.

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Non-hardware revenue, which can have a gross profit margin that is approximately 20 to 30 percentage points higher than hardware-related revenue, depending on the model and quantity of the hardware units sold, was 27% of revenue for the second quarter and 28% of revenue for the first six months of 2013 and compares to approximately 20% of total revenue for the second quarter and 24% for the first six months of 2012. We plan to continue to focus on sales of our non-hardware revenue items and expect that they will increase as a percentage of our total revenue in future periods.

### **Operating Expenses**

Our operating expenses are generally based on anticipated revenue levels and the majority of such expenses are fixed over short periods of time. As a result, small variations in the amount of revenue recognized in any given quarter could cause significant variations in the quarter-to-quarter comparisons of either the absolute amounts of operating income or operating income as a percentage of revenue.

The most significant factor driving our operating expenses is our headcount. Direct compensation and benefit plan expenses generally represent between 55% and 65% of our operating expenses. In addition, a number of other expense categories are directly related to headcount. We attempt to manage our headcount within the context of the economic environments in which we operate and the investments that we believe we need to make to help ensure that our infrastructure is able to support future growth and ensure that our products are competitive.

On a consolidated basis, our operating expenses for the quarter and six months ended June 30, 2013 were \$21,958 and \$42,330, respectively, an increase of \$1,504, or 7%, from the second quarter of 2012 and an increase of \$2,213, or 6%, from the six months ended June 30, 2012.

The increase in consolidated operating expenses for the second quarter of 2013 compared to the second quarter of 2012 was primarily related a 7% increase in average headcount partially offset by a decrease in long-term incentive plan costs. The increase in consolidated operating expenses for the six months ended June 30, 2013 compared to the six months ended June 30, 2012 was primarily related a 5% increase in average headcount partially offset by a decrease in long-term incentive plan costs.

Operating expenses for the second quarter and first six months of 2013 included \$604 and \$1,358 of expenses related to long-term incentive plan costs, respectively, compared to \$1,170 and \$2,248 of long-term incentive plan costs for the second quarter and first six months of 2012, respectively.

### *Sales and Marketing Expenses*

Consolidated sales and marketing expenses for the quarter ended June 30, 2013 were \$10,470, an increase of \$614, or 6%, from the second quarter of 2012. Consolidated sales and marketing expenses for the six months ended June 30, 2013, were \$20,101, an increase of \$837, or 4%, from the same period of 2012. The increase in sales and marketing expenses for both periods reflected an increase in average headcount partially offset by a decrease in long-term incentive plan costs.

Average full-time sales, marketing, support, and operating employee headcount for the three and six months ended June 30, 2013 was 187 and 180, respectively compared to 171 and 170 for the three and six months ended June 30, 2012, respectively. The increase in headcount was approximately 9% for the second quarter and 6% for the six months ended June 30, 2013 when compared to the same periods in 2012.

### *Research and Development Expenses*

Consolidated research and development expenses for the quarter ended June 30, 2013, were \$5,345, an increase of \$549, or 11%, from the second quarter of 2012. Consolidated research and development costs for the six months ended June 30, 2013, were \$10,192, an increase of \$695, or 7%, from the same period of 2012. The increase in research and development expenses for both periods reflected an increase in average headcount and the purchase of Cronto Limited in the second quarter of 2013 partially offset by a decrease in long-term incentive plan costs.

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Average full-time research and development employee headcount for the three and six months ended June 30, 2013 was 144 compared to 140 and 137 for the three and six months ended June 30, 2012, respectively. The increase in headcount was approximately 3% and 5% for the second quarter and six months ended June 30, 2013, respectively, when compared to the same periods in 2012.

### *General and Administrative Expenses*

Consolidated general and administrative expenses for the quarter ended June 30, 2013, were \$5,492, an increase of \$162, or 3%, from the second quarter of 2012. Consolidated general and administrative expenses for the six months ended June 30, 2013, were \$10,944, an increase of \$539 or 5%, from the same period of 2012. The increase in general and administrative expenses in both periods reflected an increase in average headcount and an increase in professional services primarily related to our acquisition of Cronto Limited in the second quarter of 2013.

Average full-time general and administrative employee headcount for the three and six months ended June 30, 2013 was 60 and 58, respectively, compared to 55 for both the three and six months ended June 30, 2012.

### *Amortization of Intangible Assets*

Amortization of intangible assets for the second quarter and first six months of 2013 was \$651 and \$1,093, respectively, an increase of \$179 when compared to the second quarter of 2012 and an increase of \$142 when compared to the six months ended June 30, 2012. The increase in amortization expense for the second quarter primarily reflects the amortization of purchased intangible assets related to the acquisition of Cronto Limited in the second quarter of 2013. For the first six months, the increase primarily reflects the amortization of purchased intangible assets related to the acquisition of Cronto partially offset by the fact that intangibles related to our purchase of Able, NV in 2006 were fully amortized in the first quarter of 2013.

### **Interest Income**

Consolidated net interest income was \$40 in the second quarter of 2013 as compared to income of \$68 in the second quarter of 2012. For the six months ended June 30, 2013, interest income was \$82 compared to \$145 for the same period of 2012. The decrease in interest income for the second quarter and first six months of 2013 compared to the same periods in 2012 reflects a reduction in the average interest rate earned on the invested balances partially offset by an increase in the average invested balance.

Our average cash balance in the second quarter and first six months of 2013 of \$95,634 and \$102,164 was 7.6% and 14.5% higher, respectively, than in the second quarter and first six months of 2012. Our annual return on invested cash was approximately 0.2% for the both second quarter and six months ended June 30, 2013, respectively, compared to 0.3% for both of the comparable periods in 2012.

### **Other Income (Expense), Net**

Other income (expense) primarily includes exchange gains (losses) on transactions that are denominated in currencies other than our subsidiaries functional currencies, subsidies received from foreign governments in support of our research and development in those countries and other miscellaneous non-operational, non-recurring expenses.

Other income for the second quarter of 2013 was \$265 and compares to other income of \$300 for the second quarter of 2012. The decrease in other income primarily reflects a decline in subsidies received from foreign governments. Other income (expense) included no significant exchange gains or losses for the quarter ended June 30, 2013 compared to an exchange loss of \$49 for the quarter ended June 30, 2012.

Other income for the first six months of 2013 was \$413 and compares to \$532 for the first six months of 2012. Other income included exchange losses of \$91 for the six months ended June 30, 2013 compared to an exchange gain of \$46 for the six months ended June 30, 2012.

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### **Income Taxes**

Income tax expense for the second quarter of 2013 was \$379, a decrease of \$1,588 from the second quarter of 2012. Income tax expense for the first six months of 2013 was \$873, a decrease of \$1,624 from the same period in 2012. The decrease in tax expense in 2013 from 2012 in both periods is attributable to lower pretax income and a lower effective tax rate. The effective tax rate was 17% for both the second quarter and first six months of 2013 compared to 21% for both periods in 2012.

The decline in the tax rate was primarily related to taxable payments in 2012 and prior from our U.S. and Swiss subsidiaries to certain other subsidiaries for the purchase of intangible assets. In 2012, the payments had the effect of shifting income to higher tax rate jurisdictions. The payments are no longer required in 2013.

The effective tax rate for both periods reflects our estimate of our full-year tax rate at the end of each respective period. The decrease in the tax rate is primarily attributable to an increase in pretax income in tax jurisdictions that either have a lower statutory tax rate or have tax loss carryforwards that have been reserved. We believe that our effective tax rate may vary significantly quarter to quarter as actual earnings or losses are realized in countries with differing tax rates or with loss carryforwards that have been reserved.

At December 31, 2012, we had \$11,620 of U.S. NOL carryforwards, of which, \$9,093 represents U.S. tax deductions for employee stock option gains, the tax benefit of which will be credited to additional paid in capital when the NOL carryforwards are utilized. The U.S. NOL carryforwards expire in varying amounts beginning in 2022 and continuing through 2032.

At December 31, 2012, we had foreign NOL carryforwards of \$5,279 and other foreign deductible carryforwards of \$3,491. The foreign NOL carryforwards have no expiration dates and the other deductible carryforwards expire from 2016 to 2019. At December 31, 2012, we had a valuation allowance of \$2,284 for certain foreign deferred tax assets.

### **Loss from Discontinued Operations**

We reported an after-tax loss from discontinued operations of \$41 and income of \$333 for the quarter and six months ended June 30, 2013, respectively. The loss for the quarter ended June 30, 2013 include ongoing expenses related to the bankruptcy and discontinuation of the DigiNotar business in the third quarter of 2011. The income reported in the first six months of 2013 reflected a change in the estimated cost to settle certain liabilities accrued in previous periods. The after tax losses of \$236 and \$319 for the quarter and six months ended June 30, 2012, respectively, reflect the results of the DigiNotar operation during those time periods.

### **Liquidity and Capital Resources**

Our net cash balance was \$85,649 at June 30, 2013, a decrease of \$18,995 or 18%, from \$104,644 at March 31, 2013, and a decrease of \$20,820, or 20%, from \$106,469 at December 31, 2012. The decrease in cash from both March 31, 2013 and December 31, 2012 was primarily attributable to the cash paid for the acquisition of Cronto Limited in the second quarter of 2013 and to the purchase of end-of-life processors as described in our 10-K for the year ended December 31, 2012. We paid Euro 15,000, or \$19,500 using an exchange rate of 1.3, to acquire Cronto. We purchased approximately \$9,930 of end-of-life processors in the first six months of 2013 and have firm commitments to purchase an additional \$1,274 of such processors in the remaining quarters of 2013.

As of June 30, 2013, we held \$61,832 of cash in banks outside of the United States. Of that amount, \$61,290 is not subject to significant repatriation restrictions, but may be subject to taxes upon repatriation. We have not provided for taxes on our unremitted foreign earnings as we consider them to be permanently invested.

We believe that our financial resources are adequate to meet our operating needs for the next twelve months.

At June 30, 2013 we had working capital of \$112,451, a decrease of \$18,475, or 14%, from \$130,926 at March 31, 2013 and a decrease of \$17,036 or 13% from \$129,487 reported at December 31, 2012. The decrease in working capital for the quarter and six months ended June 30, 2013 was primarily related to the acquisition of Cronto.

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### **Recently Issued Accounting Pronouncements**

From time to time, new accounting pronouncements are issued by the FASB or other standards setting bodies that are adopted by us as of the specified effective date. Unless otherwise discussed, our management believes that the impact of recently issued standards that are not yet effective will not have a material impact on our consolidated financial statements upon adoption.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

There have been no material changes in our market risk during the three and six months ended June 30, 2013. For additional information, refer to Item 7A. Quantitative and Qualitative Disclosures about Market Risk, included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

### **Item 4. Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, who, respectively, are our principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q our disclosure controls and procedures were effective to provide reasonable assurance that (i) the information required to be disclosed by us in our reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and (ii) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

### **Changes in Internal Controls**

There were no changes in our internal control over financial reporting (as that term is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) during the three and six months ended June 30, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Inherent Limitations on the Effectiveness of Controls**

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. However, our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls' effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings.** On September 19, 2011, one of our wholly-owned subsidiaries, DigiNotar B.V., a company organized and existing in The Netherlands, filed a bankruptcy petition under Article 4 of the Dutch Bankruptcy Act in the Haarlem District Court, The Netherlands. On September 20, 2011, the court declared DigiNotar B.V. bankrupt and appointed a bankruptcy trustee and a bankruptcy judge to manage all affairs of DigiNotar B.V. through the bankruptcy process. The trustee took over management of DigiNotar B.V.'s business activities and is responsible for the administration and liquidation of DigiNotar B.V. In connection with the bankruptcy of DigiNotar B.V., subsequent to September 20, 2011, a number of claims and counter claims have been filed in The Netherlands related to discontinued assets and discontinued liabilities and other available remedies.

**Item 6. Exhibits.**

Exhibit 31.1 - Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated August 2, 2013.

Exhibit 31.2 - Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, dated August 2, 2013.

Exhibit 32.1 - Section 1350 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated August 2, 2013.

Exhibit 32.2 - Section 1350 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated August 2, 2013.

Exhibit 101.INS XBRL Instance Document

Exhibit 101.SCH XBRL Taxonomy Extension Schema Document

Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase Document

Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

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**SIGNATURES**

Pursuant to the requirements 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, on August 2, 2013.

VASCO Data Security International, Inc.

/s/ T. Kendall Hunt

T. Kendall Hunt

Chief Executive Officer and Chairman of the Board

of Directors (Principal Executive Officer)

/s/ Clifford K. Bown

Clifford K. Bown

Executive Vice President and Chief Financial Officer

(Principal Financial Officer and Principal

Accounting Officer)

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\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Act of 1934 and otherwise are not subject to liability.