VASCO DATA SECURITY INTERNATIONAL INC
Form 10-Q
November 03, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2015

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM __________ TO __________

Commission file number 000-24389

VASCO Data Security International, Inc.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**36-4169320**
(State or Other Jurisdiction of	**(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. x 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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition 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 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 x No

There were 39,827,034 shares of Common Stock, $.001 par value per share, outstanding at October 30, 2015.

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VASCO Data Security International, Inc.

Form 10-Q

For The Quarterly Period Ended September 30, 2015

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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, Cronto and IDENTIKEY.

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VASCO Data Security International, Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	September 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Current assets		
Cash and equivalents	$ 144,002	$ 72,441
Short term investments	39,977	64,940
Accounts receivable, net of allowance for doubtful accounts of $975 in 2015 and $223 in 2014	36,867	29,994
Inventories	21,902	33,875
Prepaid expenses	2,330	2,312
Foreign sales tax receivable	444	598
Deferred income taxes	225	906
Other current assets	985	1,160
Total current assets	246,732	206,226
Property and equipment:		
Furniture and fixtures	5,252	5,231
Office equipment	10,972	10,751
	16,224	15,982
Accumulated depreciation	(13,603)	(13,157)
Property and equipment, net	2,621	2,825
Goodwill, net of accumulated amortization	21,060	22,208
Intangible assets, net of accumulated amortization	9,556	12,819
Other assets, net of accumulated amortization	6,671	7,260
Total assets	$ 286,640	$ 251,338
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 4,357	$ 10,680
Deferred revenue	19,001	17,830
Accrued wages and payroll taxes	8,026	8,458
Income taxes payable	2,840	1,899
Other accrued expenses	6,557	5,413
Deferred compensation	1,071	806

Liabilities of discontinued operations		84		111
Total current liabilities		41,936		45,197
Other long-term liabilities		39		55
Deferred income taxes		77		213
Total liabilities		42,052		45,465
Stockholders equity				
Common stock: $.001 par value per share, 75,000 shares authorized; 39,793 and 39,660 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively		40		40
Preferred stock: 500 shares authorized, none issued and outstanding at September 30, 2015 or December 31, 2014		0		0
Additional paid-in capital		84,769		82,450
Accumulated income		164,553		125,885
Accumulated other comprehensive income		(4,774)		(2,502)
Total stockholders equity		244,588		205,873
Total liabilities and stockholders equity	$	286,640	$	251,338

See accompanying notes to condensed consolidated financial statements.

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VASCO Data Security International, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	**2014**	**2015**	**2014**
Revenue	$ 60,027	$ 52,633	$ 190,555	$ 139,111
Cost of goods sold	23,755	17,038	78,111	46,699
Gross profit	36,272	35,595	112,444	92,412
Operating costs:				
Sales and marketing	8,842	10,729	28,616	32,410
Research and development	4,378	4,441	13,465	14,784
General and administrative	8,506	5,440	21,730	16,447
Amortization of purchased intangible assets	1,091	1,143	3,348	3,392
Total operating costs	22,817	21,753	67,159	67,033
Operating income	13,455	13,842	45,285	25,379
Interest income	107	35	284	70
Other income (expense)	(25)	(986)	(28)	(300)
Income from continuing operations before income taxes	13,537	12,891	45,541	25,149
Provision for income taxes	2,351	1,682	6,831	3,521
Net income from continuing operations	11,186	11,209	38,710	21,628
Income (loss) from discontinued operations	(4)	(46)	(42)	(68)
Net income	$ 11,182	$ 11,163	$ 38,668	$ 21,560
Net income per share:				
Basic income (loss) per share				
Continuing	$ 0.28	$ 0.28	$ 0.97	$ 0.55
Discontinued	(0.00)	(0.00)	(0.00)	(0.00)

Total	$ 0.28	$ 0.28	$ 0.97	$ 0.55
Diluted income (loss) per share				
Continuing	$ 0.28	$ 0.28	$ 0.97	$ 0.55
Discontinued	(0.00)	(0.00)	(0.00)	(0.00)
Total	$ 0.28	$ 0.28	$ 0.97	$ 0.55
Weighted average common shares outstanding:				
Basic	39,580	39,358	39,563	39,330
Diluted	39,733	39,541	39,711	39,467

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)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Net income	$ 11,182	$ 11,163	$ 38,668	$ 21,560
Other comprehensive income - Cumulative translation adjustment	(10)	(2,858)	(2,272)	(2,695)
Comprehensive income	$ 11,172	$ 8,305	$ 36,396	$ 18,865

See accompanying notes to condensed consolidated financial statements.

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VASCO Data Security International, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine months ended September 30, 2015	2014
Cash flows from operating activities:		
Net income from continuing operations	$ 38,710	$ 21,628
Adjustments to reconcile net income from continuing operations to net cash provided by continuing operations:		
Depreciation and amortization	4,359	4,675
Deferred tax expense (benefit)	1,724	(858)
Stock-based compensation	2,726	1,840
Changes in assets and liabilities:		
Accounts receivable, net	(9,021)	(564)
Inventories	11,972	(5,777)
Foreign sales tax receivable	143	213
Other current assets	56	834
Accounts payable	(6,240)	2,473
Income taxes payable	1,086	(966)
Accrued expenses	673	3,602
Current deferred compensation	265	411
Deferred revenue	1,382	2,526
Net cash provided by operating activities of continuing operations	47,835	30,037
Cash flows from investing activities of continuing operations:		
Purchase of short term investments	(74,807)	(64,916)
Maturities of short term investments	99,768	19,992
Additions to property and equipment	(914)	(1,212)
Additions to intangible assets	(75)	(112)
Other assets	(3)	(1,309)
Net cash provided by (used in) investing activities of continuing operations	23,969	(47,557)
Cash flows from financing activities of continuing operations:		
Proceeds from exercise of stock options	0	51
Tax payments for restricted stock issuances	(837)	(123)
Tax benefit of stock-based compensation	430	253
Net cash provided by (used in) financing activities of continuing operations	(407)	181

Cash flows used in discontinued operations:				
Net cash used in operating activities of discontinued operations		(69)		(56)
Net cash used in discontinued operations		(69)		(56)
Effect of exchange rate changes on cash		233		(227)
Net increase (decrease) in cash		71,561		(17,622)
Cash and equivalents, beginning of year		72,441		98,607
Cash and equivalents, end of period	$	144,002	$	80,985

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. (VASCO) 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 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, 2014.

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 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. Revenue and expenses are translated at average exchange rates prevailing during the year. Translation adjustments arising from differences in exchange rates are charged or credited to other comprehensive income. Gains and losses resulting from foreign currency transactions are included in the consolidated statements of operations in other income (expense).

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 nine month periods ended September 30, 2015, foreign currency transactions resulted in losses of $294 and $1,062, respectively, compared to losses of $1,208 and $1,109, respectively, for the same periods in 2014.

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 approximately 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. *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.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (ASU 2014-09), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in applying such process, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP.

ASU 2014-09 is effective for annual periods beginning after December 15, 2016, and interim periods within such annual periods, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures).

In August 2015, the FASB issued Accounting Standards Update No. 2015-14, Revenue from Contracts with Customers: Deferral of Effective Date deferring the new revenue standard one year and allowing early adoption as of the original effective date.

We are currently evaluating the impact of our pending adoption of ASU 2014-09 and 2015-14 on our consolidated financial statements and have not yet determined the method by which we will adopt the standard and whether we will elect early adoption.

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 and commercial paper, with original maturities of three months or less. Cash is held by a number of U.S. and non-U.S. commercial banks.

Short Term Investments

Short term investments are stated at cost plus accrued interest, which approximates fair value. Short term investments consist of bank certificates of deposit and high quality commercial paper with original maturities of more than three and less than twelve months.

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.

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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 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 a market approach 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.

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 nine months ended September 30, 2015.

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 foreign tax credit, net operating loss, and other deductible carryforwards in certain jurisdictions 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 September 30, 2015 and December 31, 2014, our financial instruments were cash equivalents, short term investments, 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 September 30, 2015 and December 31, 2014.

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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 8. 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.

Note 2 - 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:

	September 30, 2015	December 31, 2014
Component parts	$ 10,169	$ 15,727
Work-in-process and finished goods	11,733	18,148
Total	$ 21,902	$ 33,875

Note 3 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.

The loss from discontinued operations, net of tax, for the three and nine months ended September 30, 2015 was $4 and $42, respectively, compared to losses of $46 and $68 for the same periods in 2014.

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At September 30, 2015 and December 31, 2014, liabilities of discontinued operations consist of the following:

	September 30, 2015	December 31, 2014
Accrued professional fees	$ 2	$ 25
Income tax payable	82	86
Liabilities of discontinued operations	$ 84	$ 111

Note 4 Goodwill

Goodwill activity for the nine months ended September 30, 2015 consisted of the following:

Net balance at December 31, 2014	$ 22,208
Net foreign currency translation	(1,148)
Net balance at September 30, 2015	$ 21,060
September 30, 2015 balance at cost	$ 21,914
Accumulated amortization	(854)
Net balance at September 30, 2015	$ 21,060

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

Note 5 Intangible Assets

Intangible asset activity for the nine months ended September 30, 2015 is detailed in the following table.

	Capitalized Technology	Patents & Trademarks	Other	Total Intangible Assets
Net balance at December 31, 2014	$ 10,216	$ 1,929	$ 674	$ 12,819
Additions-Other	0	106	0	106
Net foreign currency translation	(7)	0	(14)	(21)
Amortization expense	(3,065)	(114)	(169)	(3,348)
Net balance at September 30, 2015	$ 7,144	$ 1,921	$ 491	$ 9,556
September 30, 2015 balance at cost	$ 28,033	$ 2,539	$ 1,106	$ 31,678
Accumulated amortization	(20,889)	(618)	(615)	(22,122)

Net balance at September 30, 2015	$	7,144	$	1,921	$	491	$	9,556

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

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Note 6 Income Taxes

Our effective tax rate for the nine months ended September 30, 2015 is equal to our expected 2015 annual tax rate of 15%. 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 half of 2015, our annual tax rate was estimated to be 14%. Our effective tax rate for the third quarter of 2015 was 17%. It is higher than the expected annual rate because it includes an adjustment for the first half of 2015 to account for the increase in the expected annual rate from 14% to 15%.

The effective tax rate for the nine months ended September 30, 2014 was equal to our expected 2014 annual tax rate of 14%. This was lower than the U.S. statutory rate primarily due to income in foreign jurisdictions taxed at lower rates. In the first half of 2014, our expected annual rate was estimated to be 15%. Our effective rate for the quarter ended September 30, 2014 was 13%. The effective rate for the third quarter was lower than the expected annual rate because it included an adjustment for the first half of 2014 for the reduction in the expected annual rate from 15% to 14%.

At December 31, 2014, we had foreign tax credit carryforwards of $5,516 for future U.S. tax returns. Foreign tax credits of $944 expire in 2015 and the remaining $4,572 expire in 2023 and 2024. We have not provided a valuation reserve for the foreign tax credits as we believe it is more likely than not that they will be realized.

At December 31, 2014, we had foreign net operating loss (NOL) carryforwards of $4,366 and other foreign deductible carryforwards of $3,568. The foreign NOL carryforwards have no expiration dates and the other deductible carryforwards expire from 2016 to 2021. At December 31, 2014, we had a valuation allowance of $2,378 for certain foreign deferred tax assets and $122 for a U.S. state NOL carryforward.

Note 7 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 September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Balance, beginning of period	$ 53	$ 59	$ 85	$ 116
Provision for claims	14	65	127	133
Product or cash issued to settle claims	(23)	(20)	(168)	(145)
Balance, end of period	$ 44	$ 104	$ 44	$ 104

At September 30, 2015, deferred revenue from extended warranties was $68.

Note 8 Long-Term Compensation Plan and Stock Based Compensation

Under the VASCO Data Security International, Inc. 2009 Equity Incentive Plan (2009 Equity Incentive Plan), we awarded 162 shares of restricted stock in the first quarter of 2015 consisting of 147 unissued shares subject to future performance criteria and 15 issued shares. The market value of the 15 issued restricted shares of $400 at the date of grant is being amortized over the vesting period of one year. The market value of the 147 unissued shares subject to performance criteria of $3,994 at the date of grant is being amortized over the respective vesting periods of one to four years.

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The following table details long-term compensation plan and stock-based compensation expense for the three and nine months ended September 30, 2015 and 2014:

	Three months ended September 30, 2015	Three months ended September 30, 2014	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Restricted stock	$ 1,049	$ 630	$ 2,726	$ 1,840
Long-term compensation plan	509	351	1,382	570
Total Non-Cash Compensation	$ 1,558	$ 981	$ 4,108	$ 2,410

Note 9 Common Stock and Earnings per Share

In connection with the 2009 Equity Incentive Plan, during the nine months ended September 30, 2015, we issued 132 total shares of restricted common stock, 15 shares for awards granted in the first quarter of 2015 and 117 performance shares related to awards provisioned in prior years.

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 nine months ended September 30, 2015 and 2014 follow:

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VASCO Data Security International, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Net income from continuing operations	$ 11,186	$ 11,209	$ 38,710	$ 21,628
Income (loss) from discontinued operations	(4)	(46)	(42)	(68)
Net income	$ 11,182	$ 11,163	$ 38,668	$ 21,560
Net income per share:				
Basic income (loss) per share				
Continuing	$ 0.28	$ 0.28	$ 0.97	$ 0.55
Discontinued	(0.00)	(0.00)	(0.00)	(0.00)
Total	$ 0.28	$ 0.28	$ 0.97	$ 0.55
Diluted income (loss) per share				
Continuing	$ 0.28	$ 0.28	$ 0.97	$ 0.55
Discontinued	(0.00)	(0.00)	(0.00)	(0.00)
Total	$ 0.28	$ 0.28	$ 0.97	$ 0.55
Weighted average common shares outstanding:				
Basic	39,580	39,358	39,563	39,330
Diluted	39,733	39,541	39,711	39,467

Note 10 Contingencies

During the second quarter of 2015, our management became aware that certain of our products which were sold by our European subsidiary to a third-party distributor may have been resold by the distributor to parties in Iran, potentially including parties whose property and interests in property may be blocked pursuant to Executive Order 13224, Executive Order 13382 or that may be identified under Section 560.304 of 31 C.F.R. Part 560 as the Government of Iran .

The Audit Committee of the Company s Board of Directors has initiated an internal investigation to review this matter with the assistance of outside counsel. We have stopped all shipments to such distributor pending the outcome of the investigation. As a precautionary matter, concurrent initial notices of voluntary disclosure were submitted on June 25, 2015 with each of the U.S. Department of the Treasury, Office of Foreign Assets Control (OFAC), and the U.S. Department of Commerce, Bureau of Industry and Security (BIS). We will file a further report with each of OFAC and BIS after completing our review and fully intend to cooperate with both agencies. Our total revenues from all sales to the particular distributor during the period relevant to review by OFAC and BIS (June 1, 2010 through June 25, 2015) were approximately $3.1 million.

OFAC and BIS will review the results of our investigation when it is submitted. Following that review, OFAC and BIS may conclude that the disclosed sales resulted in violations of U.S. economic sanctions and/or export control laws and warrant the imposition of civil penalties, such as fines, limitations on the our ability to export products from the United States, and/or referral for further investigation by the U.S. Department of Justice. While the filing of a voluntary disclosure may be a mitigating factor in consideration of any penalties by these agencies, any resulting fines or restrictions may nonetheless be material to our financial results in the period in which they are imposed, but at this time we are not able to estimate the possible loss or range of loss in connection with this matter. Additionally, disclosure of this conduct and any fines or other action relating to this conduct could harm our reputation and have a material adverse effect on our business, operating results and financial condition. We cannot predict when OFAC and BIS will conclude their own review of our voluntary self-disclosures or whether they may impose any penalties.

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On July 28, 2015 a putative class action complaint was filed in the United States District Court for the Northern District of Illinois, captioned Linda J. Rossbach v. Vasco Data Security International, Inc., et al., case number 1:15-cv-06605, naming VASCO and certain of its current executive officers as defendants and alleging violations under the Securities Exchange Act of 1934, as amended. The suit was purportedly filed on behalf of a putative class of investors who purchased VASCO securities between February 18, 2014 and July 21, 2015, and seeks to recover damages allegedly caused by the defendants alleged violations of the federal securities laws and to pursue remedies under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The complaint seeks certification as a class action and unspecified compensatory damages plus interest and attorneys fees. Pursuant to a September 1, 2015 scheduling order entered by the court, the lead plaintiff, once appointed, will have sixty days to file an amended complaint or notify the defendants that the lead plaintiff intends to rely on the current complaint. The defendants will then have sixty days to answer or otherwise respond to the operative complaint. Although the ultimate outcome of litigation cannot be predicted with certainty, the Company believes that this lawsuit is without merit and intends to defend against the action vigorously.

On October 9, 2015, a derivative complaint was filed in the United States District Court for the Northern District of Illinois, captioned Elizabeth Herrera v. Hunt, et al., case number 1:15-cv-08937, naming VASCO s Board of Directors and certain of its executive officers as individual defendants and the Company as a nominal defendant. On October 22, 2015, a second derivative complaint was filed in the Circuit Court of Cook County, Illinois, captioned Beth Seltzer v. Hunt, et al., case number 2015-ch-15541, naming the same defendants. The complaints assert, among other things, that the individual defendants breached their fiduciary duties by making material misstatements in, and omitting material information from, the Company s public disclosures and by failing to maintain adequate internal controls and properly manage the Company. Among other things, the complaints seek unspecified compensatory damages and injunctive relief. On October 29, 2015, the Seltzer action was removed to the United States District Court for the Northern District of Illinois.

Note 11 - Subsequent Event

On October 6, 2015, VASCO Data Security International, Inc. (VASCO) and 685102 N.B. Inc., a wholly-owned subsidiary of VASCO (Purchaser), entered into an Arrangement Agreement (the Arrangement Agreement), providing for the acquisition by VASCO through Purchaser of Silanis Technology Inc. (STI), a leading provider of electronic signature (e-signature) and digital transaction solutions used to sign, send and manage documents, for an aggregate purchase price of $85.0 million, subject to adjustment as provided in the Arrangement Agreement.

The Arrangement Agreement contains customary representations, warranties and covenants of the parties to the Arrangement Agreement, including, among others, covenants of the parties to use commercially reasonable efforts to cause the acquisition to be consummated on or about November 24, 2015 or as soon thereafter as reasonably possible (but not during December 2015) and in any event by January 31, 2016 or such other date as the parties may agree to in writing.

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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 percentages)

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 , should , objective , goal , possible , po 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 additional 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, 2014 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. These risks, uncertainties and other factors include the risk that the announced acquisition (Acquisition) of Silanis Technology, Inc. (Silanis) is not completed on a timely basis or at all; VASCO s ability to integrate Silanis into the business of VASCO successfully and the amount of time and expense spent and incurred in connection with the integration; the risk that the revenue synergies, cost savings and other economic benefits that VASCO anticipates as a result of the Acquisition are not fully realized or take longer to realize than expected. 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 quarter and nine months ended September 30, 2015 and 2014 (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 both proprietary and 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. Many of our software DIGIPASSES are focused on the mobile platform and can be downloaded directly to mobile devices, such as DIGIPASS for Mobile, while others are integrated directly into mobile applications (using DIGIPASS for Apps) that are downloaded onto mobile devices. 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 businesses 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 and mobile banking, our customer banks corporate and retail customers. 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.

We offer our products either through: (a) a product sales and licensing model or (b) through our services platform, which includes our cloud-based service offering, DIGIPASS as a Service (DPaaS) or MYDIGIPASS (MDP) or together (DPaaS/MDP). 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) companies that want to verify identities through our platform or (c) consumers that are aware of the dangers posed by identity theft.

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 cyber-crime, 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 the European Union and European Central Bank continue to implement new programs to adapt to changing economic conditions in the region, Europe continues to struggle with sovereign debt issues and, over the first nine months of 2015, a currency, primarily the Euro, which has weakened against the U.S. Dollar and other currencies. As a result, we expect that Europe will continue to face difficult economic conditions in 2015. 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.

In the third quarter of 2015, revenue from our Europe, Middle East and Africa (EMEA) region, which accounted for 66% of our total revenue, increased 29% when compared to the third quarter of 2014. For the first nine months of 2015, revenue from our EMEA region, which accounted for 69% of our total revenue, increased 57% when compared to the first nine months of 2014. The increase in revenue from our EMEA region in the third quarter and first nine months of 2015 reflected delivery of a significant amount of card readers using our Cronto technology to Rabobank. Excluding shipments to Rabobank, we believe revenues in the third quarter and first nine months of 2015 compared to the same periods in 2014 primarily reflected the timing of when orders are received and goods are shipped rather than being attributable to changes in the economic environment.

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. New products and services that we introduced to the market, such as DPaaS/MDP, 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.

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.

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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. company and the Swiss company. 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 rates for the primary foreign tax jurisdictions range 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 and the benefit that is realized in the U.S. and 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 contracting subsidiaries pretax income is reasonably assured while the pretax income of the U.S. and Swiss subsidiaries varies directly with our overall success in the market.

Comparison of Results for the Three and Nine months ended September 30, 2015 and 2014

Currency Fluctuations: In both the third quarter and first nine months of 2015, approximately 96% of our revenue was generated outside the United States. While the majority of our revenues are generated outside of the United States, the majority of our revenue in the third quarter and first nine months of 2015 were denominated in U.S. Dollars. We estimate that 79% of our revenues for both the third quarter and first nine months of 2015 were denominated in U.S. Dollars. In addition, in the third quarter and first nine months of 2015, approximately 64% and 67%, respectively, of our operating expenses were generated/incurred outside of the United States. 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.

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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 of 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, on average, strengthened against the Euro approximately 21% for the quarter and 22% for the nine months ended September 30, 2015, as compared to the same periods in 2014. We estimate that the change in currency rates in 2015 compared to 2014 resulted in a decrease in revenue of approximately $2,454 and $7,652 for the quarter and nine months ended September 30, 2015, respectively, compared to the same periods in 2014 and a decrease in operating expenses of approximately $2,354 and $7,483 for the quarter and nine months ended September 30, 2015, respectively, compared to the same periods in 2014.

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 $10 and $2,272 for the third quarter and first nine months of 2015, respectively, and other comprehensive loss of $2,858, and $2,695 in the in the third quarter and first nine months of 2014, respectively. These amounts are included as a separate component of stockholders equity. The functional currency for both 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 income (expense). Foreign exchange transaction losses aggregating $294 in the third quarter of 2015 compare to foreign exchange transaction losses of $1,208 in the third quarter of 2014. Foreign exchange transaction losses aggregating $1,062 in the first nine months of 2015 compare to foreign exchange transaction losses of $1,109 in the first nine months of 2014.

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; and 4) Other Countries, including Australia, Latin America and India. The breakdown of revenue in each of our major geographic areas was as follows:

	EMEA	United States	Asia Pacific	Other Countries	Total
Three months ended September 30:					
Revenue:					
2015	$ 39,362	$ 2,522	$ 12,206	$ 5,937	$ 60,027
2014	30,528	4,109	14,257	3,739	52,633
Percent of Total:					
2015	66%	4%	20%	10%	100%

2014	58%	8%	27%	7%	100%
Nine months ended September 30:					
Revenue:					
2015	$ 132,322	$ 8,208	$ 34,361	$ 15,664	$ 190,555
2014	84,302	8,745	33,672	12,392	139,111
Percent of Total:					
2015	70%	4%	18%	8%	100%
2014	61%	6%	24%	9%	100%

Total revenue in the third quarter of 2015 increased $7,394, or 14%, from the third quarter of 2014. For the first nine months of 2015, total revenue increased $51,444 or 37% from the first nine months of 2014. The increase in revenue in the third quarter and first nine months of 2015 compared to the same periods in 2014 primarily reflected the delivery of a significant amount of card readers using our Cronto technology sold to Rabobank. Revenue related to our delivery of all products to Rabobank globally exceeded 30% of total revenue in both the third quarter and first nine months of 2015. For the first nine months of 2015, revenue from all other customers, excluding Rabobank, decreased by less than 5% compared to the same period in 2014, but would have increased by less than 5% if the currency exchange rates in 2015 had been the same as in 2014. Please see the discussion below under Revenue by Target Market for additional information regarding the changes in revenue from the Banking and the Enterprise and Application Security markets.

Revenue generated in EMEA during the third quarter of 2015 was $8,834, or 29%, higher than the third quarter of 2014. For the first nine months of 2015, revenue generated in EMEA was $48,020, or 57% higher than the first nine months of 2014. The increase in revenues in the third quarter of 2015 compared to the third quarter of 2014 reflected an increase in revenue from the Banking market partially offset by a decline in revenue from the Enterprise and Application Security market. The increase in revenue in the first nine months of 2015 compared to the same period in 2014 primarily reflected an increase in revenue from the Banking market. Revenue resulting from the sale of card readers to Rabobank discussed above are recorded as EMEA revenue.

Revenue generated in the United States for the third quarter of 2015 was $1,587, or 39%, lower than the third quarter of 2014. For the first nine months of 2015, revenue generated in the United States was $537, or 6% lower than the first nine months of 2014. The decrease in revenue for the third quarter of 2015 compared to the same period in 2014 reflected a decrease in revenue from both the Banking and Enterprise and Application Security markets. The decrease in revenues for the first nine month of 2015 compared to the same period in 2014 was primarily due to a reduction in revenue from the Banking market.

Revenue generated in the Asia Pacific region during the third quarter of 2015 was $2,051, or 14%, lower than the third quarter of 2014. For the first nine months of 2015 revenue was $689, or 2% higher than the first nine months of 2014. The decrease in revenues for the third quarter 2015 compared to the third quarter of 2014 reflected a decrease in revenue from both the Banking and Enterprise and Application Security markets. Revenues for the first nine months of 2015 compared to the same period in 2014 reflected an increase in revenue from the Banking market partially offset by a decrease in revenue from the Enterprise and Application Security market.

Revenue generated from Other Countries during the third quarter of 2015 was $2,198, or 59%, higher than the third quarter of 2014. For the first nine months of 2015 revenue was $3,272, or 26%, higher than the first nine months of 2014. The increase in revenues from Other Countries in the third quarter and first nine months of 2015 compared to the same periods in 2014 was primarily due to an increase in revenues from the Banking market in Latin America partially offset by a decline in revenues from the Enterprise and Application Security market in Australia.

With our sales and licensing business model, we believe the comparison of revenues is heavily influenced by the timing of when orders are received and goods are shipped. We also expect that revenues from regions other than EMEA will be more volatile given the 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 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
Three months ended September 30:			
Revenue:			
2015	$ 52,919	$ 7,108	$ 60,027
2014	44,413	8,220	52,633
Percent of Total:			
2015	88%	12%	100%
2014	84%	16%	100%
Nine months ended September 30:			
Revenue:			
2015	$ 168,001	$ 22,554	$ 190,555
2014	116,067	23,044	139,111
Percent of Total:			
2015	88%	12%	100%
2014	83%	17%	100%

Revenue in the third quarter of 2015 from the Banking market increased $8,506, or 19%, from the third quarter of 2014 and revenue from the Enterprise and Application Security market decreased $1,112, or 14%, in the same period. Revenue for the first nine months of 2015 from the Banking market increased $51,934, or 45%, compared to the first nine months of 2014, while revenue from the Enterprise and Application Security market decreased $490 or 2% in the same period.

The increase in revenue from the Banking market for the third quarter and first nine months of 2015 compared to the same periods in 2014 was primarily due to an increase in revenue from card reader products sold partially offset by a decline in non-hardware revenues. The decrease in revenue from the Enterprise and Application Security market for the third quarter of 2015 compared to the third quarter of 2014 was due to decline in both hardware and non-hardware products sold, partially offset by an increase in revenue from maintenance and support. The decrease in revenue from the Enterprise and Application Security market for the first nine months of 2015 compared to the same period in 2014 was due to decline in both hardware and non-hardware products sold, partially offset by an increase in revenue from maintenance and support.

The increase in revenue from the Banking market in the third quarter of 2015 compared to the third quarter of 2014 primarily reflected increases in revenue from EMEA and Latin America, partially offset by declines in revenue from the United States and Asia Pacific. Revenue from the Banking market for the first nine months of 2015 compared to the same period of 2014, increased in all regions other than in the United States. 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.

Revenues in the Enterprise and Application Security market in the third quarter of 2015 compared to the third quarter of 2014 declined in all regions. For the first nine months of 2015 compared to the same period of 2014 revenue from the Enterprise and Application Security market primarily reflected lower revenue from the Asia Pacific and Other Countries.

The respective changes in revenue in both markets reflects the transactional nature of our business where the absolute amount of revenue reported in any given period is a reflection of transactions closed in that period. Because of the volatility in our business, we believe that the overall strength of our business is best evaluated over a longer term where the impact of transactions being recorded in any given period are not as significant as they appear to be in a quarter-over-quarter comparison.

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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 and nine months ended September 30, 2015 and 2014:

AS A PERCENTAGE OF REVENUE

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	39.6%	32.4%	41.0%	33.6%
Gross profit	60.4%	67.6%	59.0%	66.4%
Operating costs:				
Sales and marketing	14.7%	20.4%	15.0%	23.3%
Research and development	7.3%	8.4%	7.1%	10.6%
General and administrative	14.2%	10.3%	11.4%	11.8%
Amortization of purchased intangible assets	1.8%	2.2%	1.7%	2.5%
Total operating costs	38.0%	41.3%	35.2%	48.2%
Operating income	22.4%	26.3%	23.8%	18.2%
Interest income	0.2%	0.1%	0.1%	0.1%
Other income (expense), net	(0.1)%	(1.9)%	0.0%	(0.2)%
Income from continuing operations before income taxes	22.5%	24.5%	23.9%	18.1%
Provision for income taxes	3.9%	3.2%	3.6%	2.6%
Net income from continuing operations	18.6%	21.3%	20.3%	15.5%

Gross Profit

Consolidated gross profit for the quarter ended September 30, 2015 was $36,272, an increase of $677, or 2%, from the quarter ended September 30, 2014. Gross profit as a percentage of revenue (gross profit margin) was 60% for the quarter ended September 30, 2015, as compared to 68% for the quarter ended September 30, 2014. The decrease in gross profit as a percentage of revenue for the third quarter of 2015 compared to 2014 primarily reflects:

a decline in the gross margins from hardware products sold in the Banking market,

- the unfavorable impact of the strengthening of the U.S. Dollar to the Euro,
- an unfavorable mix of products sold, with revenues from the Enterprise and Application Security market decreasing as a percentage of our total revenue, and
- a decline in non-hardware revenue as a percentage of our total revenue.

Consolidated gross profit for the nine months ended September 30, 2015 was $112,444, an increase of $20,032, or 22%, from the comparable period in 2014. Gross profit as a percentage of revenue (gross profit margin) was 59% for the nine months ended September 30, 2015 and 66% for the nine months ended September 30, 2014. The decrease in gross profit as a percentage of revenue for the first nine months of 2015 compared to 2014 primarily reflects the same factors noted above for the comparison of the third quarter of 2015 to the third quarter of 2014.

The gross margins generated from the banking market in any specific period will vary based on a number of factors including, but not limited to, the products sold, the quantity sold, the geographic location of the sales and competition based on product or geography. Generally, we experience significant competition when the sale involves card readers. Card readers generally have a gross profit margin that is approximately 25 to 35 percentage points lower than other hardware-related margins due to competitive pricing pressures. There are a number of competitors in the EMV (Europay, Mastercard and VISA) market that produce card reader products with fewer features at a lower cost than our products. Card readers represented 35% and 40% of our total revenue in the third quarter and first nine months of 2015, respectively, as compared to 12% and 17% of our total revenue in the third quarter and first nine months of 2014.

The majority of our inventory purchases are denominated in U.S. Dollars. Also, as previously noted, our sales are denominated in various currencies including the Euro. As the U.S. Dollar strengthened against the Euro in the third quarter and first nine months of 2015 compared to the same periods of 2014, revenue from sales made in Euros decreased, as measured in U.S. Dollars, without a corresponding change in the cost of goods sold. As noted earlier, the impact from changes in currency rates are estimated to have decreased revenue by approximately $2,454 and $7,652 in the third quarter and first nine months of 2015, respectively. Had the currency rates in 2015 been equal to the rates in 2014, the gross profit margin would have been approximately 1.6 percentage points higher for both the third quarter and first nine months of 2015.

The decrease in the percentage of our revenue that came from the Enterprise and Application Security market reflected the fact that revenue from that segment increased 14% and 2% for the third quarter and first nine months of 2015, respectively, while revenue from the Banking market increased 19% and 45% in the third quarter and first nine months of 2015, respectively, compared to the same periods in 2014. Revenue from our Enterprise and Application Security market, which generally has margins that are 30 to 40 percentage points higher than the Banking market, was 12% of our total revenue in both the third quarter and first nine months of 2015 compared to 16% and 17% of total revenue in the third quarter and first nine months of 2014, respectively.

Similarly, revenue from our non-hardware products generally has margins that are 30 to 40 percentage points higher than our hardware products. The amount of revenue from our non-hardware products decreased 22% and 4% in the third quarter and first nine months of 2015, respectively, compared to the comparable periods of 2014. As a percentage of total revenue, non-hardware revenue was 21% and 20% in the third quarter and first nine months of 2015, respectively, compared to 31% and 29% of revenue in the third quarter and first nine months of 2014, respectively.

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.

Generally, 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 we believe we need to make for our infrastructure to support future growth and for our products to remain competitive. For the third quarter and first nine months of 2015, average headcount was 3% higher and 3% lower, respectively, than the same periods in 2014.On a consolidated basis, our operating expenses for the quarter and nine months ended September 30, 2015 were $22,817 and $67,159, respectively, an increase of $1,064, or 5%, from the third quarter of 2014 and an increase of $126, or less than 1%, from the nine months ended September 30, 2014. The increase in consolidated operating expenses for the third quarter of 2015 compared to the same period in 2014 was primarily related to:

the benefit of the strengthening of the U.S. Dollar to the Euro and other foreign currencies, partially offset by;

increased long-term incentive compensation expenses, and

increased professional fees, primarily legal expenses.

While our total operating expenses for the first nine months of 2015 were essentially flat with the operating expenses for 2014, the comparison primarily reflected the same components as noted in the comparison of the third quarter of 2015 compared to the third quarter of 2014.

Historically, operating expenses can be impacted by changes in foreign exchange rates. As noted above, we estimate that the change in currency rates in 2015 compared to 2014 resulted in a decrease in operating expenses of approximately $2,354 and $7,483 for the third quarter and nine months ended September 30, 2015, respectively, compared to the same periods in 2014.

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The comparison of operating expenses can also be impacted significantly by costs related to our stock-based and long-term incentive plans. Operating expenses for the third quarter and first nine months of 2015 included $1,558 and $4,108, respectively, of expenses related to long-term incentive plan costs compared to $981 and $2,411 of long-term incentive plan costs for the third quarter and first nine months of 2014, respectively.

Professional fees, including the benefit of changes in currency exchange rates, increased approximately $1,663 and $2,319 for the third quarter and first nine months of 2015, respectively, compared to the same periods in 2014. The increased expense primarily reflected an increase in legal expenses due in large part to our previously disclosed internal investigation related to the possible sale of our products by a distributor into Iran and due diligence related to the announced acquisition of Silanis.

Sales and Marketing Expenses

Consolidated sales and marketing expenses for the quarter ended September 30, 2015 were $8,842, a decrease of $1,887, or 18%, from the third quarter of 2014. Consolidated sales and marketing expenses for the nine months ended September 30, 2015, were $28,616, a decrease of $3,794, or 12%, from the same period of 2014. The decrease in sales and marketing expenses for both periods reflected the benefit of the strengthening of the U.S. Dollar to other foreign currencies.

Average full-time sales, marketing, support, and operating employee headcount for the three and nine months ended September 30, 2015 was 185 and 184, respectively compared to 183 and 189 for the three and nine months ended September 30, 2014, respectively. Headcount was approximately 1% higher for the third quarter of 2015 compared to the third quarter of 2014 and 3% lower for the nine months ended September 30, 2015 when compared to the same period in 2014.

Research and Development Expenses

Consolidated research and development expenses for the quarter ended September 30, 2015, were $4,378, a decrease of $63, or 1%, from the third quarter of 2014. Consolidated research and development costs for the nine months ended September 30, 2015, were $13,465, a decrease of $1,319, or 9%, from the same period of 2014. The decrease in research and development for both periods reflected the benefit of the strengthening of the U.S. Dollar to other foreign currencies.

Average full-time research and development employee headcount for the three and nine months ended September 30, 2015 was 138 and 136, respectively compared to 134 and 140 for the three and nine months ended September 30, 2014, respectively. Headcount was approximately 3% higher for the third quarter of 2015 compared to the third quarter of 2014 and 3% lower for the nine months ended September 30, 2015 when compared to the same period in 2014.

General and Administrative Expenses

Consolidated general and administrative expenses for the quarter ended September 30, 2015, were $8,506, an increase of $3,066, or 56%, from the third quarter of 2014. Consolidated general and administrative expenses for the nine months ended September 30, 2015, were $21,730, an increase of $5,283, or 32%, when compared to the same period of 2014. The increase in general and administrative expenses in both the third quarter and first nine months of 2015 compared to the comparable periods in 2014 primarily reflected the increase in long-term incentive plan expense and the increase in professional fees noted above partially offset by the benefit of the strengthening of the U.S. Dollar to foreign currencies.

Average full-time general and administrative employee headcount for the three and nine months ended September 30, 2015 was 60 and 58, respectively, compared to 57 and 58 for the three and nine months ended September 30, 2014, respectively. Average headcount for the third quarter of 2015 was 5% higher than in the third quarter of 2014 and unchanged for the first nine months of 2015 compared to the same period in 2014.

Amortization of Intangible Assets

Amortization of intangible assets for the third quarter and first nine months of 2015 was $1,091 and $3,348, respectively, a decrease of $52 when compared to the third quarter of 2014 and a decrease of $44 when compared to the nine months ended September 30, 2014.

Interest Income

Consolidated net interest income was $107 in the third quarter of 2015 as compared to $35 in the third quarter of 2014. For the nine months ended September 30, 2015, interest income was $284 compared to $70 for the same period of 2014. The increase in interest income for the third quarter and first nine months of 2015 compared to the same periods in 2014 reflects an increase in the average interest rate earned on the invested balances and an increase in the average invested balance.

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Our average cash balance in the third quarter and first nine months of 2015 of $172,559 and $155,393, respectively, was 40% and 37% higher, than in the third quarter and first nine months of 2014, respectively. Our annual return on invested cash was approximately 0.25% and 0.24% for the third quarter and nine months ended September 30, 2015, respectively, compared to 0.12% and 0.08% for the comparable periods in 2014, respectively.

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 expense for the third quarter of 2015 was $25 compared to $986 for the third quarter of 2014. Other income (expense) included exchange losses of $294 for the quarter ended September 30, 2015 compared to exchange losses of $1,208 for the quarter ended September 30, 2014.

Other expense for the first nine months of 2015 was $28 compared to $300 for the first nine months of 2014. Other expense included exchange losses of $1,062 for the nine months ended September 30, 2015 compared to exchange losses of $1,109 for the nine months ended September 30, 2014.

Income Taxes

Income tax expense for the third quarter of 2015 was $2,351, an increase of $669 from the third quarter of 2014. Income tax expense for the first nine months of 2015 was $6,831, an increase of $3,310 from the same period in 2014. The increase in tax expense in 2015 from 2014 in both periods is attributable to higher pretax income. The effective tax rate was 17% for the third quarter and 15% for the first nine months of 2015 compared to 13% and 14% for the third quarter and first nine months of 2014, respectively.

The effective tax rate for both periods reflects our estimate of our full-year tax rate at the end of each respective period. The increase in the tax rate at the end of the third quarter of 2015 compared to the end of the third quarter in 2014 is primarily attributable to an increase in pretax income in tax jurisdictions that have a higher statutory tax rate. 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, 2014, we had foreign tax credit carryforwards of $5,516. Foreign tax credits of $944 expire in 2015 and the remaining $4,572 expire in 2023 and 2024. We have not provided a valuation reserve for the foreign tax credits because we believe that it is more likely than not that they will be realized.

At December 31, 2014, we also had foreign NOL carryforwards of $4,366 and other foreign deductible carryforwards of $3,568. The foreign NOL carryforwards have no expiration dates and the other deductible carryforwards expire from 2016 to 2021. At December 31, 2014, we had a valuation allowance of $2,378 for certain foreign deferred tax assets and $122 for U.S. state tax NOL. See Note 6 to the condensed consolidated financial statements for more information on tax loss carryforwards.

Loss from Discontinued Operations

We reported an after-tax loss from discontinued operations of $4 and $42 for the quarter and nine months ended September 30, 2015, respectively. The loss for both periods include ongoing expenses related to the bankruptcy and discontinuation of the DigiNotar business in the third quarter of 2011. The after tax losses of $46 and $68 for the quarter and nine months ended September 30, 2014, respectively, were also attributable to expenses related to the bankruptcy and discontinuation of the DigiNotar business.

Liquidity and Capital Resources

At September 30, 2015, we had net cash balances (total cash, cash equivalents and restricted cash less bank borrowings) of $144,002 and short-term investments of $39,978. At June 30, 2015, we had net cash balances of $82,110 and short-term investments of $74,900. At December 31, 2014, we had net cash balances of $72,441 and short-term investments of $64,940. We had no outstanding debt or restricted cash at September 30, 2015, June 30, 2015 or December 31, 2014.

Short-term investments at September 30, 2015, March 31, 2015, and December 31, 2014, consisting of high quality commercial paper with maturities of less than nine months, were held by our U.S. and Swiss entities and issued by domestic and foreign corporations.

Our working capital at September 30, 2015 was $204,796, an increase of $12,937 or 7% from $191,859 at June 30, 2015, and an increase of $43,767 or 27% from $161,029 at December 31, 2014. Our current ratio was 5.9 to 1.0 at September 30, 2015. The increase in the combined balance of cash and short-term investments as well as the increase in working capital at September 30, 2015 from December 31, 2014 primarily reflects the benefit from the cash flow from operations for the third quarter and first nine months of 2015.

As of September 30, 2015, we held $103,167 of cash and short-term investments in banks outside of the United States. Of that amount, $102,653 is not subject to repatriation restrictions, but may be subject to taxes upon repatriation.

On October 6, 2015, VASCO Data Security International, Inc. (VASCO) entered into an agreement providing for the acquisition of Silanis for an aggregate purchase price of $85.0 million, subject to adjustment. The agreement contains covenants of the parties to use commercially reasonable efforts to cause the acquisition to be consummated on or about November 24, 2015 or as soon thereafter as reasonably possible (but not during December 2015) and in any event by January 31, 2016 or such other date as the parties may agree to in writing. We expect to utilize short term investments and cash in banks to fund the acquisition.

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

Recently Issued Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (ASU 2014-09), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in applying such process, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP.

ASU 2014-9 is effective for annual periods beginning after December 15, 2016, and interim periods within such annual periods, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures).

In August, 2015, the FASB issued Accounting Standards Update No. 2015-14, Revenue from Contracts with Customers: Deferral of Effective Date, which allowed companies to defer implementation of ASU 2014-9 one year but also allowed early adoption as of the original effective date.

We are currently evaluating the impact of our pending adoption of ASU 2014-09 and Update No. 2015-14 on our consolidated financial statements and have not yet determined the method by which we will adopt the standard.

From time to time, new accounting pronouncements are issued by the FASB or other standard 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 nine months ended September 30, 2015. 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, 2014.

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.

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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 months ended September 30, 2015, 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

On July 28, 2015 a putative class action complaint was filed in the United States District Court for the Northern District of Illinois, captioned Linda J. Rossbach v. Vasco Data Security International, Inc., et al., case number 1:15-cv-06605, naming VASCO and certain of its current executive officers as defendants and alleging violations under the Securities Exchange Act of 1934, as amended. The suit was purportedly filed on behalf of a putative class of investors who purchased VASCO securities between February 18, 2014 and July 21, 2015, and seeks to recover damages allegedly caused by the defendants alleged violations of the federal securities laws and to pursue remedies under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The complaint seeks certification as a class action and unspecified compensatory damages plus interest and attorneys fees. Pursuant to a September 1, 2015 scheduling order entered by the court, the lead plaintiff, once appointed, will have sixty days to file an amended complaint or notify the defendants that the lead plaintiff intends to rely on the current complaint. The defendants will then have sixty days to answer or otherwise respond to the operative complaint. Although the ultimate outcome of litigation cannot be predicted with certainty, the Company believes that this lawsuit is without merit and intends to defend against the action vigorously.

On October 9, 2015, a derivative complaint was filed in the United States District Court for the Northern District of Illinois, captioned Elizabeth Herrera v. Hunt, et al., case number 1:15-cv-08937, naming VASCO s Board of Directors and certain of its executive officers as individual defendants and the Company as a nominal defendant. On October 22, 2015, a second derivative complaint was filed in the Circuit Court of Cook County, Illinois, captioned Beth Seltzer v. Hunt, et al., case number 2015-ch-15541, naming the same defendants. The complaints assert, among other things, that the individual defendants breached their fiduciary duties by making material misstatements in, and omitting material information from, the Company s public disclosures and by failing to maintain adequate internal controls and properly manage the Company. Among other things, the complaints seek unspecified compensatory damages and injunctive relief. On October 29, 2015, the Seltzer action was removed to the United States District Court for the Northern District of Illinois.

In January 2015, we received a notice of potential claim by the trustee against all of the individuals who served as Directors of DigiNotar, both before and after our acquisition of DigiNotar. T. Kendall Hunt, Jan Valcke, and Clifford K. Bown were the Directors of DigiNotar following its purchase by VASCO. The basis for the potential claim from the trustee appears to be based primarily on the same arguments that VASCO presented in its case against the sellers, which were adjudicated in VASCO s favor. The trustee has invited the directors (both former and new) to respond to the preliminary conclusion before he makes a decision to file a claim. While we believe that we have strong defenses against the claim, we have also notified our provider of director and officer insurance should a claim be filed and we do not expect the resolution of the potential claim to have a material adverse effect on our business, financial condition or results of operations. VASCO is indemnifying Messrs. Hunt, Valcke, and Bown for this matter.

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Item 5. Other Information.

Section 219 of the U.S. Iran Threat Reduction and Syria Human Rights Act of 2012 (ITRA) added new Section 13(r) to the U.S. Securities Exchange Act of 1934 requiring each SEC reporting issuer to disclose in its annual and, if applicable, quarterly reports certain activities of the issuer, and its affiliates, during the period covered by the report, relating to Iran or with the Government of Iran or certain other persons sanctioned by the U.S. under programs relating to terrorism or the proliferation of weapons of mass destruction. The required disclosure includes disclosure of activities not prohibited by U.S. or other law even if conducted outside the U.S. by non-U.S. affiliates in compliance with local law and whether or not the activities are sanctionable under U.S. law. Section 13(r) is effective for Form 10-Qs or 10-K s first required to be filed after February 6, 2013.

During the second quarter of 2015, VASCO management became aware that certain of its products which were sold by a VASCO European subsidiary to a third-party distributor may have been resold by the distributor to parties in Iran, potentially including parties whose property and interests in property may be blocked pursuant to Executive Order 13224, Executive Order 13382 or that may be identified under Section 560.304 of 31 C.F.R. Part 560 as the Government of Iran .

The Audit Committee of the Company s Board of Directors has initiated an internal investigation to review this matter with the assistance of outside counsel. While we are electing to disclose these matters, the investigation is ongoing and no determination has been reached that disclosure under 13(r) is required. VASCO has stopped all shipments to such distributor pending the outcome of the investigation. As a precautionary matter, concurrent initial notices of voluntary disclosure were submitted on June 25, 2015 with each of the U.S. Department of the Treasury, Office of Foreign Assets Control (OFAC), and the U.S. Department of Commerce, Bureau of Industry and Security (BIS). The Company will file a further report with each of OFAC and BIS after completing its review and fully intends to cooperate with both agencies. Total VASCO revenues from all sales to the particular distributor during the period relevant to review by OFAC and BIS (June 1, 2010 through June 25, 2015) were approximately $3.1 million.

OFAC and BIS will review the results of the Company s investigation when it is submitted. Following that review, OFAC and BIS may conclude that the disclosed sales resulted in violations of U.S. economic sanctions and/or export control laws and warrant the imposition of civil penalties, such as fines, limitations on the Company s ability to export products from the United States, and/or referral for further investigation by the U.S. Department of Justice. While the filing of a voluntary disclosure may be a mitigating factor in consideration of any penalties by these agencies, any resulting fines or restrictions may nonetheless be material to the Company s financial results in the period in which they are imposed, but at this time the Company is not able to estimate the possible loss or range of loss in connection with this matter. Additionally, disclosure of this conduct and any fines or other action relating to this conduct could harm the Company s reputation and have a material adverse effect on our business, operating results and financial condition. The Company cannot predict when OFAC and BIS will conclude their own review of our voluntary self-disclosures or whether they may impose any penalties.

As further described in Form 8-K filed October 13, 2015, on October 6, 2015, VASCO Data Security International, Inc. (VASCO) and 685102 N.B. Inc., a wholly-owned subsidiary of VASCO (Purchaser), entered into an Arrangement Agreement (the Arrangement Agreement), providing for the acquisition by VASCO through Purchaser of Silanis Technology Inc. (STI), a leading provider of electronic signature (e-signature) and digital transaction solutions used to sign, send and manage documents, for an aggregate purchase price of $85.0 million, subject to adjustment as provided in the Arrangement Agreement.

The Arrangement Agreement contains customary representations, warranties and covenants of the parties to the Arrangement Agreement, including, among others, covenants of the parties to use commercially reasonable efforts to cause the acquisition to be consummated on or about November 24, 2015 or as soon thereafter as reasonably possible (but not during December 2015) and in any event by January 31, 2016 or such other date as the parties may agree to in writing

Item 6. Exhibits.

Exhibit 2.1* - Arrangement Agreement, dated October 6, 2015, among VASCO Data Security International, Inc., 685102 N.B. Inc., Silanis Technology Inc., Silanis International Limited, Silanis Canada Inc. and Silanis Agent Inc. (Incorporated by reference - Form 8K filed October 13, 2015.)

Exhibit 10.1 - Form of Support and Voting Agreements, entered into by VASCO Data Security International, Inc. and 685102 N.B. Inc. with STI, SIL and certain security holders of STI and SIL. (Incorporated by reference - Form 8K filed October 13, 2015.)

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 November 3, 2015.

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 November 3, 2015.

Exhibit 32.1 - Section 1350 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 3, 2015.

Exhibit 32.2 - Section 1350 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 3, 2015.

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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

* Certain exhibits, schedules and annexes have been omitted pursuant to Item 601(b)(2) of Regulation S-K. VASCO undertakes to furnish supplementally copies of any such omitted items upon request by the Securities and Exchange Commission.

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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 November 3, 2015.

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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EXHIBIT INDEX

Exhibit 2.1* - Arrangement Agreement, dated October 6, 2015, among VASCO Data Security International, Inc., 685102 N.B. Inc., Silanis Technology Inc., Silanis International Limited, Silanis Canada Inc. and Silanis Agent Inc. (Incorporated by reference - Form 8K filed October 13, 2015.)

Exhibit 10.1 - Form of Support and Voting Agreements, entered into by VASCO Data Security International, Inc. and 685102 N.B. Inc. with STI, SIL and certain security holders of STI and SIL. (Incorporated by reference - Form 8K filed October 13, 2015.)

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 November 3, 2015.

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 November 3, 2015.

Exhibit 32.1 - Section 1350 Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 3, 2015.

Exhibit 32.2 - Section 1350 Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, dated November 3, 2015.

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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