

CLEARONE INC
Form 10-Q
May 15, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

or

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

For the transition period _____ to _____

Commission file number: 001-33660

CLEARONE, INC.

(Exact name of registrant as specified in its charter)

Utah

(State or other jurisdiction of incorporation or organization)

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

(Address of principal executive offices)

(801) 975-7200

(Registrant's telephone number, including area code)

87-0398877

(I.R.S. employer identification number)

84116

(Zip Code)

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

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

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

Larger Accelerated Filer

Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company) Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

APPLICABLE ONLY TO CORPORATE ISSUERS:

The number of shares of ClearOne common stock outstanding as of April 30, 2015 was 9,116,029.

CLEARONE, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2015

INDEX

| | |
|---|-----------|
| PART I – FINANCIAL INFORMATION | |
| <u>Item 1. Financial Statements</u> | <u>1</u> |
| <u>Condensed Consolidated Balance Sheets as of March 31, 2015 Unaudited and December 31, 2014</u> | <u>1</u> |
| <u>Condensed Consolidated Statements of Operations for the three months ended March 31, 2015 and 2014 Unaudited</u> | <u>2</u> |
| <u>Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2015 and 2014 Unaudited</u> | <u>3</u> |
| <u>Notes to Condensed Consolidated Financial Statements Unaudited</u> | <u>5</u> |
| <u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>13</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | <u>19</u> |
| <u>Item 4. Controls and Procedures</u> | <u>19</u> |
| PART II – OTHER INFORMATION | |
| <u>Item 1. Legal Proceedings</u> | <u>20</u> |
| <u>Item 1A. Risk Factors</u> | <u>20</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | <u>20</u> |
| <u>Item 3. Defaults Upon Senior Securities</u> | <u>20</u> |
| <u>Item 4. Mine Safety Disclosures</u> | <u>20</u> |
| <u>Item 5. Other Information</u> | <u>20</u> |
| <u>Item 6. Exhibits</u> | <u>20</u> |

Table of Contents

PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CLEARONE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except par value)

| | March 31, 2015 Unaudited | December 31, 2014 |
|--|-----------------------------|-------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$10,865 | \$7,440 |
| Marketable securities | 7,314 | 6,994 |
| Receivables, net of allowance for doubtful accounts of \$79 and \$58, respectively | 8,593 | 9,916 |
| Inventories | 13,869 | 12,766 |
| Distributor channel inventories | 1,540 | 1,698 |
| Deferred income taxes | 3,824 | 3,824 |
| Prepaid expenses and other assets | 1,267 | 2,143 |
| Total current assets | 47,272 | 44,781 |
| Long-term marketable securities | 18,133 | 19,162 |
| Long-term inventories, net | 690 | 876 |
| Property and equipment, net | 1,901 | 2,039 |
| Intangibles, net | 7,581 | 7,896 |
| Goodwill | 12,724 | 12,724 |
| Deferred income taxes | 1,265 | 1,265 |
| Other assets | 115 | 117 |
| Total assets | \$89,681 | \$88,860 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$3,854 | \$3,057 |
| Accrued liabilities | 2,508 | 2,694 |
| Deferred product revenue | 4,684 | 5,004 |
| Total current liabilities | 11,046 | 10,755 |
| Deferred rent | 222 | 248 |
| Other long-term liabilities | 1,304 | 1,841 |
| Total liabilities | 12,572 | 12,844 |
| Shareholders' equity: | | |
| Common stock, par value \$0.001, 50,000,000 shares authorized, 9,111,790 and 9,097,827 shares issued and outstanding | 9 | 9 |
| Additional paid-in capital | 45,204 | 44,939 |
| Accumulated other comprehensive (loss) | (133 |) (8 |
| Retained earnings | 32,029 | 31,076 |
| Total shareholders' equity | 77,109 | 76,016 |
| Total liabilities and shareholders' equity | \$89,681 | \$88,860 |

See accompanying notes

Table of Contents

CLEARONE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Dollars in thousands, except per share amounts)

| | Three months ended March 31, | |
|--|------------------------------|-----------|
| | 2015 | 2014 |
| Revenue | \$13,586 | \$12,708 |
| Cost of goods sold | 5,124 | 5,006 |
| Gross profit | 8,462 | 7,702 |
| Operating expenses: | | |
| Sales and marketing | 2,622 | 2,737 |
| Research and product development | 1,941 | 2,241 |
| General and administrative | 2,000 | 1,968 |
| Total operating expenses | 6,563 | 6,946 |
| Operating income | 1,899 | 756 |
| Other income, net | 104 | 81 |
| Income before income taxes | 2,003 | 837 |
| Provision for income taxes | 731 | 352 |
| Net income | \$1,272 | \$485 |
| Basic earnings per common share | \$0.14 | \$0.05 |
| Diluted earnings per common share | \$0.13 | \$0.05 |
| Basic weighted average shares outstanding | 9,100,107 | 9,082,546 |
| Diluted weighted average shares outstanding | 9,508,479 | 9,558,941 |
| Comprehensive income: | | |
| Net income | \$1,272 | \$485 |
| Other comprehensive income: | | |
| Unrealized gain on available-for-sale securities, net of tax | 55 | 73 |
| Change in foreign currency translation adjustment | (180 |) — |
| Comprehensive income | \$1,147 | \$558 |

See accompanying notes

CLEARONE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

| | Three months ended March 31, | |
|---|------------------------------|---------|
| | 2015 | 2014 |
| Cash flows from operating activities: | | |
| Net income | \$1,272 | \$485 |
| Adjustments to reconcile net income to net cash provided by operations: | | |
| Depreciation and amortization expense | 521 | 324 |
| Amortization of deferred rent | (23 |) (21 |
| Stock-based compensation expense | 238 | 84 |
| Provision for (recoveries of) doubtful accounts, net | 21 | (27 |
| Write-down of inventory to net realizable value | 47 | 416 |
| Loss on disposal of assets | — | 2 |
| Tax benefit from exercise of stock options | (7 |) (87 |
| Changes in operating assets and liabilities: | | |
| Receivables | 1,205 | 853 |
| Inventories | (806 |) 40 |
| Deferred income taxes | — | 44 |
| Prepaid expenses and other assets | 877 | 886 |
| Accounts payable | 820 | 178 |
| Accrued liabilities | (832 |) 210 |
| Income taxes payable | 338 | 235 |
| Deferred product revenue | (291 |) (51 |
| Other long-term liabilities | (537 |) — |
| Net cash provided by operating activities | 2,843 | 3,571 |
| Cash flows from investing activities: | | |
| Payment towards business acquisitions | — | (13,060 |
| Purchase of property and equipment | (76 |) (249 |
| Purchase of patents | — | (90 |
| Proceeds from maturities and sales of marketable securities | 2,376 | — |
| Purchases of marketable securities | (1,612 |) (780 |
| Net cash provided by (used in) investing activities | 688 | (14,179 |
| Cash flows from financing activities: | | |
| Proceeds from the exercise of stock options | 20 | 1,021 |
| Tax benefits from stock options | 7 | 87 |
| Stock registration costs | — | (55 |
| Net cash provided by financing activities | 27 | 1,053 |
| Effect of exchange rate changes on cash and cash equivalents | (133 |) — |
| Net increase (decrease) in cash and cash equivalents | 3,425 | (9,555 |
| Cash and cash equivalents at the beginning of the period | 7,440 | 17,192 |
| Cash and cash equivalents at the end of the period | \$10,865 | \$7,637 |
| See accompanying notes | | |

CLEARONE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

The following is a summary of supplemental cash flow activities:

| | Three months ended March 31, | |
|---|------------------------------|-------|
| | 2015 | 2014 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | \$881 | \$29 |
| Issuance of common stock in connection with acquisition of business | — | 1,679 |

See accompanying notes

4

CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

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

Business Description:

ClearOne, Inc. and its subsidiaries (collectively, “ClearOne” or the “Company”) are a global company that designs, develops and sells conferencing, collaboration, streaming and digital signage solutions for audio and visual communications. The performance and simplicity of its advanced comprehensive solutions offer unprecedented levels of functionality, reliability and scalability.

Basis of Presentation:

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

These accompanying interim condensed consolidated financial statements for the three months ended March 31, 2015 and 2014, respectively, have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and are not audited. Certain information and footnote disclosures that are usually included in financial statements prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) have been either condensed or omitted in accordance with SEC rules and regulations. The accompanying consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of our financial position as of March 31, 2015 and December 31, 2014, the results of operations for the three months ended March 31, 2015 and 2014, and the statements of cash flows for the three months ended March 31, 2015 and 2014. The results of operations for the three months ended March 31, 2015 and 2014 are not necessarily indicative of the results for a full-year period. These interim condensed consolidated financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC.

Significant Accounting Policies:

The significant accounting policies were described in Note 1 to the audited consolidated financial statements included in the Company’s annual report on Form 10-K for the year ended December 31, 2014. There have been no changes to these policies during the three months ended March 31, 2015 that are of significance or potential significance to the Company.

Recent Accounting Pronouncements:

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for the Company on January 1, 2017. The Company has not yet selected a transition method and is currently evaluating the effect that the

updated standard will have on the consolidated financial statements.

2. Earnings Per Share

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

5

CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

| | Three months ended March 31, | |
|---|------------------------------|-----------|
| | 2015 | 2014 |
| Numerator: | | |
| Net income | \$ 1,272 | \$ 485 |
| Denominator: | | |
| Basic weighted average shares outstanding | 9,100,107 | 9,082,546 |
| Dilutive common stock equivalents using treasury stock method | 408,372 | 476,395 |
| Diluted weighted average shares outstanding | 9,508,479 | 9,558,941 |
| Basic earnings per common share | \$0.14 | \$0.05 |
| Diluted earnings per common share | \$0.13 | \$0.05 |
| Weighted average options outstanding | 1,037,137 | 1,044,208 |
| Anti-dilutive options not included in the computations | 268,709 | 116,000 |

3. Business Combination

Acquisition of Sabine

On March 7, 2014, the Company completed the acquisition of Sabine, Inc. ("Sabine") through a stock purchase agreement ("SPA"). Sabine manufactures, designs and sells Sacom professional wireless microphone systems for live and installed audio. It also makes FBX Feedback Exterminator for reliable automatic feedback control. With the addition of Sabine, ClearOne will have reliable and exclusive access to the wireless microphones that are a critical component of ClearOne's complete microphone portfolio.

Pursuant to the SPA, the Company (i) paid initial consideration of \$8,141 in cash, (ii) accrued for possible additional earn-out payments over the next two years, estimated to be \$657, and (iii) issued 150,000 shares of restricted common stock of the Company, valued at \$1,679 (determined on the basis of the closing market price of the Company's stock on the acquisition date). The purchase price was paid out of cash on hand. The SPA contains representations, warranties and indemnifications customary for a transaction of this type.

The following table summarizes the consideration paid for the acquisition:

| | Consideration |
|--------------------------|---------------|
| Cash | \$8,141 |
| Common stock | 1,679 |
| Contingent consideration | 657 |
| Total | \$10,477 |

The fair values of Sabine assets acquired and liabilities assumed are based on the information that was available during the measurement period of twelve months from the date of acquisition. The fair value of identified assets and liabilities acquired and goodwill is as follows:

CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

| | Fair value | |
|-------------------------------|------------|---|
| Cash | \$125 | |
| Accounts receivable | 255 | |
| Inventories | 844 | |
| Prepaid and other | 105 | |
| Intangibles | 3,970 | |
| Property, plant and equipment | 292 | |
| Other long-term assets | 11 | |
| Goodwill | 5,510 | |
| Deferred tax asset | 245 | |
| Trade accounts payable | (420 |) |
| Accrued liabilities | (405 |) |
| Stock registration costs | (55 |) |
| Total | \$10,477 | |

The goodwill of \$5,510 related to the acquisition of Sabine is composed of expected synergies in utilizing Sabine technology in ClearOne product offerings, reduction in future combined research and development expenses, and intangible assets including acquired workforce that do not qualify for separate recognition. The goodwill balance of \$5,510 related to the acquisition of Sabine is expected to be deductible for tax purposes.

Supplemental Pro Forma Information:

- 1) Revenue and net loss from the Sabine business from March 8, 2014 to March 31, 2014 were \$84 and \$163 respectively.
- 2) Revenue and earnings of the combined entity as though the business combination occurred as of January 1, 2014 were as follows:

| | Three months ended March 31, | |
|-----------------------------------|------------------------------|----------|
| | 2015 | 2014 |
| Revenue | \$13,586 | \$12,977 |
| Earnings | 1,272 | 244 |
| Basic earnings per common share | \$0.14 | \$0.03 |
| Diluted earnings per common share | \$0.13 | \$0.03 |

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

Acquisition of Spontania Business of Spain-based Dialcom Networks, S.L.

On April 1, 2014 ClearOne, Inc. closed on the acquisition of the Spontania business of Spain-based Dialcom Networks, S.L. The Spontania cloud-based service empowers customers to deploy HD video conferencing, web collaboration, and more with equipment most businesses have and use every day - video-conferencing endpoints, desktops, laptops, web browsers, tablets, and smartphones. With Spontania there is no hardware investment and the service operates off of a reservation-less model, enabling on-demand video communications from virtually anywhere, anytime, with anyone on any device.

The aggregate purchase price under the terms of the transaction was approximately €3.66 million in cash (approximately US\$5.1 million), after certain closing adjustments. ClearOne did not assume any debt or cash. The cash purchase price was paid out of cash on hand. The addition of this technology was an integral part of the company's strategy to build an all-inclusive video collaboration portfolio.

The fair value of identified assets and liabilities acquired from the Spontania acquisition was as follows:

7

CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

| | | |
|------------------------|------------|---|
| | Fair value | |
| Intangibles | \$1,335 | |
| Property and equipment | 47 | |
| Goodwill | 3,741 | |
| Accrued liabilities | (71 |) |
| Total | \$5,052 | |

The goodwill of \$3,741 relates to the acquisition of Spontania cloud-based technology and intangible assets including acquired workforce that does not qualify for separate recognition. The goodwill of \$3,741 from the Spontania acquisition is expected to be deductible for tax purposes.

Supplemental Pro Forma Information:

Revenue and earnings of the combined entity as though the business combination occurred as of January 1, 2014 is not available. The Spontania business was part of a business unit of Dialcom Networks, S.L., and thus separate stand-alone financial information for Spontania is not available.

Acquisition Expenses:

During the period ended March 31, 2015, the company incurred \$70 in total acquisition related expenses for the Sabine and Spontania acquisitions, all of which are categorized under general and administrative expenses in the Consolidated Statement of Operations.

Retroactive Restatement:

Following the completion of the valuation process for the acquisition of Sabine we reported intangible amortization to reflect the final adjusted values on Form 10-K for the year ended December 31, 2014. For the quarter ended March 31, 2015 we reported amortization based on the final intangible items. For the comparative quarter ended March 31, 2014 we have restated net income to reflect the inclusion of the revised amortization applicable to that period. Net income changed from \$490 originally reported for the three months ended March 31, 2014 to \$485. The reported retained earnings balance of \$29,482 at March 31, 2014 under the restatement would be \$29,477. The restatement did not result in a reportable change to earnings per share for the period.

4. Marketable Securities

The Company has classified its marketable securities as available-for-sale securities. These securities are carried at estimated fair value with unrealized holding gains and losses included in accumulated other comprehensive income/loss in stockholders' equity until realized. Gains and losses on marketable security transactions are reported on the specific-identification method. Dividend and interest income are recognized when earned.

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value for available-for-sale securities by major security type and class of security at March 31, 2015 and December 31, 2014 were as follows:

| Amortized cost | Gross unrealized | Gross unrealized | Estimated fair value |
|-------------------|---------------------|---------------------|-------------------------|
|-------------------|---------------------|---------------------|-------------------------|

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| | | holding gains | holding losses | |
|-------------------------------------|-----------|------------------|-------------------|-------------|
| March 31, 2015 | | | | |
| Available-for-sale securities: | | | | |
| Corporate bonds and notes | \$ 19,220 | \$ 162 | \$(48 |) \$ 19,334 |
| Municipal bonds | 6,079 | 36 | (2 |) 6,113 |
| Total available-for-sale securities | \$ 25,299 | \$ 198 | \$(50 |) \$ 25,447 |

8

CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

| | Amortized cost | Gross unrealized holding gains | Gross unrealized holding losses | Estimated fair value |
|-------------------------------------|-------------------|---|--|-------------------------|
| December 31, 2014 | | | | |
| Available-for-sale securities: | | | | |
| Corporate bonds and notes | \$ 19,804 | \$ 89 | \$(55) | \$ 19,838 |
| Municipal bonds | 6,292 | 28 | (2) | 6,318 |
| Total available-for-sale securities | \$ 26,096 | \$ 117 | \$(57) | \$ 26,156 |

Maturities of marketable securities classified as available-for-sale securities were as follows at March 31, 2015:

| | Amortized cost | Estimated fair value |
|--|-------------------|-------------------------|
| March 31, 2015 | | |
| Due within one year | \$ 7,327 | \$ 7,314 |
| Due after one year through five years | 17,611 | 17,771 |
| Due after five years through ten years | 361 | 362 |
| Total available-for-sale securities | \$ 25,299 | \$ 25,447 |

Debt securities in an unrealized loss position as of March 31, 2015 were not deemed impaired at acquisition and subsequent declines in fair value are not deemed attributed to declines in credit quality. Management believes that it is more likely than not that the securities will receive a full recovery of par value. The available-for-sale marketable securities in a gross unrealized loss position as of March 31, 2015 are summarized as follows:

| (In thousands) | Less than 12 months | | More than 12 months | | Total | Gross unrealized holding losses |
|---------------------------|-------------------------|--|-------------------------|--|----------|--|
| | Estimated fair value | Gross unrealized holding losses | Estimated fair value | Gross unrealized holding losses | | |
| As of March 31, 2015 | | | | | | |
| Corporate bonds and notes | \$ 1,127 | \$(26) | \$ 2,533 | \$(22) | \$ 3,660 | \$(48) |
| Municipal bonds | — | — | 433 | (2) | 433 | (2) |
| | \$ 1,127 | \$(26) | \$ 2,966 | \$(24) | \$ 4,093 | \$(50) |

5. Intangible Assets

Intangible assets as of March 31, 2015 and December 31, 2014 consisted of the following:

| | Estimated useful lives | March 31, 2015 | December 31, 2014 |
|------------------------------------|---------------------------|----------------|-------------------|
| Tradename | 7 years | \$ 555 | \$ 555 |
| Patents and technological know-how | 10 years | 5,850 | 5,850 |
| Proprietary software | 3 to 15 years | 4,341 | 4,341 |
| Other | 5 years | 324 | 324 |
| | | 11,070 | 11,070 |

| | | | |
|--------------------------|---------|----------|---|
| Accumulated amortization | (3,489 |) (3,174 |) |
| | \$7,581 | \$7,896 | |

The amortization of intangible assets for the three months ended March 31, 2015 and March 31, 2014 was as follows:

9

CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

| | Three months ended March 31, | |
|-----------------------------------|------------------------------|-------|
| | 2015 | 2014 |
| Amortization of intangible assets | \$315 | \$169 |

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

| Years ending December 31, | |
|---------------------------|---------|
| 2015 (remainder) | \$943 |
| 2016 | 1,121 |
| 2017 | 925 |
| 2018 | 851 |
| 2019 | 778 |
| Thereafter | 2,963 |
| | \$7,581 |

6. Inventories

Inventories, net of reserves, as of March 31, 2015 and December 31, 2014 consisted of the following:

| | March 31, 2015 | December 31, 2014 |
|----------------|----------------|-------------------|
| Current: | | |
| Raw materials | \$3,071 | \$3,056 |
| Finished goods | 12,338 | 11,408 |
| | \$15,409 | \$14,464 |
| Long-term: | | |
| Raw materials | \$70 | \$59 |
| Finished goods | 620 | 817 |
| | \$690 | \$876 |

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

Current finished goods include consigned inventory in the amounts of approximately \$1,540 and \$1,698 as of March 31, 2015 and December 31, 2014, respectively. Consigned inventory represents inventory at distributors and other customers where revenue recognition criteria have not yet been achieved.

The following table summarizes the losses incurred on valuation of inventory at lower of cost or market value and write-off of obsolete inventory during the three months ended March 31, 2015 and 2014, respectively.

| | Three months ended March 31, | |
|---|------------------------------|-------|
| | 2015 | 2014 |
| Net loss (gain) on valuation of inventory and write-off of obsolete inventory | \$47 | \$416 |

7. Share-based Compensation

Share-based compensation expense has been recorded as follows:

CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

| | Three months ended March 31, | |
|----------------------------------|------------------------------|------|
| | 2015 | 2014 |
| Cost of goods sold | \$5 | \$2 |
| Sales and marketing | 40 | 20 |
| Research and product development | 33 | 11 |
| General and administrative | 160 | 51 |
| | \$238 | \$84 |

As of March 31, 2015, the total remaining unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately \$1,084, which will be recognized over a weighted average period of 2.55 years.

8. Shareholders' Equity

The following table summarizes the change in shareholders' equity during the three months ended March 31, 2015 and 2014, respectively:

| | Three months ended March 31, | |
|--|------------------------------|----------|
| | 2015 | 2014 |
| Balance at the beginning of the period | \$76,016 | \$70,335 |
| Net income during the period | 1,272 | 485 |
| Share-based compensation | 238 | 84 |
| Tax benefit - stock option exercise | 7 | 87 |
| Exercise of stock options | 20 | 1,021 |
| Dividends | (319 |) — |
| Stock issued for acquisitions | — | 1,679 |
| Unrealized gain or loss on investments, net of tax | 55 | 73 |
| Foreign currency translation adjustment | (180 |) — |
| Balance at end of the period | \$77,109 | \$73,764 |

On April 28, 2015, the company announced a quarterly cash dividend of \$0.035 per share to be paid on May 15, 2015 to shareholders of record as of May 4, 2015.

9. Fair Value Measurements

The fair value of the Company's financial instruments reflects the amounts that the Company estimates it will receive in connection with the sale of an asset or pay in connection with the transfer of a liability in an orderly transaction between market participants at the measurement date (exit price). The fair value hierarchy prioritizes the use of inputs used in valuation techniques into the following three levels:

Level 1 - Quoted prices in active markets for identical assets and liabilities.

Level 2 - Observable inputs other than quoted prices in active markets for identical assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. This category generally includes U.S. Government and agency securities; municipal securities; mutual funds and securities sold and not yet settled.

Level 3 - Unobservable inputs.

The substantial majority of the Company's financial instruments are valued using quoted prices in active markets or based on other observable inputs. The following table sets forth the fair value of the financial instruments re-measured

by the Company as of March 31, 2015 and December 31, 2014:

11

CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

| | Level 1 | Level 2 | Level 3 | Total |
|---------------------------|---------|----------|---------|----------|
| March 31, 2015 | | | | |
| Corporate bonds and notes | \$— | \$19,334 | \$— | \$19,334 |
| Municipal bonds | — | 6,113 | — | 6,113 |
| Total | \$— | \$25,447 | \$— | \$25,447 |
| | Level 1 | Level 2 | Level 3 | Total |
| December 31, 2014 | | | | |
| Corporate bonds and notes | \$— | \$19,838 | \$— | \$19,838 |
| Municipal bonds | — | 6,318 | — | 6,318 |
| Total | \$— | \$26,156 | \$— | \$26,156 |

10. Income Taxes

The Company's forecasted effective tax rate at March 31, 2015 is 35.8%, a 3.8% increase from the 32.0% effective tax rate recorded at December 31, 2014. The forecasted effective tax rate of 35.8% excludes jurisdictions for which no benefit from forecasted current year losses is anticipated. Including losses from such jurisdictions results in a forecasted effective tax rate of 36.1%. Our forecasted effective tax rate could fluctuate significantly on a quarterly basis and could change, to the extent that earnings in countries with tax rates that differ from that of the U.S. differ, from amounts anticipated at March 31, 2015.

After discrete tax expense of \$2, the effective tax rate for the quarter ended March 31, 2015 is 36.5%. The discrete tax expense is primarily attributable to interest and penalties related to unrecognized tax benefits.

11. Subsequent Events

On April 28, 2015, the company announced a quarterly cash dividend of \$0.035 per share to be paid on May 15, 2015 to shareholders of record as of May 4, 2015.

Table of Contents

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

This report on Form 10-Q includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). All statements in this report, other than statements of historical fact, are forward-looking statements for purposes of these provisions, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance, and any statements of assumptions underlying any of the foregoing. All forward-looking statements included in this report are made as of the date hereof and are based on information available to us as of such date. We assume no obligation to update any forward-looking statement. In some cases, forward-looking statements can be identified by the use of terminology such as “may,” “will,” “expects,” “plans,” “anticipates,” “intends,” “believes,” “estimates,” “potential,” or “continue,” or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that any such expectations or any forward-looking statement will prove to be correct. Our actual results will vary, and may vary materially, from those projected or assumed in the forward-looking statements. Future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including, without limitation, product recalls and product liability claims; infringement of our technology or assertion that our technology infringes the rights of other parties; termination of supplier relationships, or failure of suppliers to perform; inability to successfully manage growth; delays in obtaining regulatory approvals or the failure to maintain such approvals; concentration of our revenue among a few customers, products or procedures; development of new products and technology that could render our products obsolete; market acceptance of new products; introduction of products in a timely fashion; price and product competition, availability of labor and materials, cost increases, and fluctuations in and obsolescence of inventory; volatility of the market price of our common stock; foreign currency fluctuations; changes in key personnel; work stoppage or transportation risks; integration of business acquisitions; and other factors referred to in our press releases and reports filed with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2014. All subsequent forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Additional factors that may have a direct bearing on our operating results are discussed in Part I, Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2014.

BUSINESS OVERVIEW

We are a global company that designs, develops and sells conferencing, collaboration, streaming and digital signage solutions for voice and visual communications. The performance and simplicity of our advanced comprehensive solutions offer unprecedented levels of functionality, reliability and scalability.

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

We have an established history of product innovation and plan to continue to apply our expertise in audio, video and network engineering to develop and introduce innovative new products and enhance our existing products. Our

end-users range from some of the world's largest and most prestigious companies and institutions to small and medium-sized businesses, higher education and government organizations, as well as individual consumers. We sell our commercial products to these end-users primarily through a global network of independent distributors who in turn sell our products to dealers, systems integrators and other value-added resellers.

Our business goals are to:

- Maintain our leading global market share in professional audio conferencing products for large businesses and organizations;

- Standardize our products amongst the Fortune 500 and other blue chip companies;

13

Table of Contents

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

- Leverage the video conferencing, streaming and digital signage technologies we have acquired over the years to enter new growth markets;
- Focus on the small and medium business (SMB) market with scaled, lower cost and less complex products and solutions;
- Capitalize on the increasing adoption of unified communications and introduce new products through information technology channels;
- Capitalize on emerging market opportunities as audio visual, information technology, unified communications and traditional digital signage converge to meet enterprise and commercial multimedia needs; and
- Expand and strengthen our sales channels.

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

Our revenues were \$13.6 million and \$12.7 million during the three months ended March 31, 2015 and 2014, respectively. The increase in revenues was due to increased sales of microphone products and professional audio products. Our gross profit increased by \$760 thousand during the three months ended March 31, 2015 compared to the three months ended March 31, 2014. Net income increased by \$787 thousand during the three months ended March 31, 2015 compared to the three months ended March 31, 2014. Net income for the three months ended March 31, 2015 increased primarily due to reduced acquisition expenses for the Sabine and Spontania acquisitions compared to the three months ended March 31, 2014.

We expect continued growth in revenue from microphone products and new products. However the prospects of growth and its magnitude in both revenues and profits in the near future would depend on the strength of the global economy and the penetration level of our new products, including products added through acquisitions. We continue to closely monitor the economic situation caused by the US government's budget cuts and global economic events.

A detailed discussion of our results of operations follows below.

ANALYSIS OF RESULTS OF OPERATIONS

Results of Operations for the three months ended March 31, 2015, and 2014

The following table sets forth certain items from our unaudited condensed consolidated statements of operations (dollars in thousands) for the three months ended March 31, 2015 and 2014, respectively, together with the percentage of total revenue which each such item represents:

| | Three months ended March 31, | | | |
|----------------------------------|------------------------------|--------------|----------|--------------|
| | 2015 | % of Revenue | 2014 | % of Revenue |
| Revenue | \$13,586 | 100% | \$12,708 | 100% |
| Cost of goods sold | 5,124 | 38% | 5,006 | 39% |
| Gross profit | 8,462 | 62% | 7,702 | 61% |
| Sales and marketing | 2,622 | 19% | 2,737 | 22% |
| Research and product development | 1,941 | 14% | 2,241 | 18% |
| General and administrative | 2,000 | 15% | 1,968 | 15% |
| Operating income | 1,899 | 14% | 756 | 6% |

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| | | | | |
|-----------------------------|---------|-----|-------|----|
| Other income (expense), net | 104 | 1% | 81 | 1% |
| Income before income taxes | 2,003 | 15% | 837 | 7% |
| Provision for income taxes | 731 | 5% | 352 | 3% |
| Net income | \$1,272 | 9% | \$485 | 4% |

Revenue

Revenue for the three months ended March 31, 2015 was approximately \$13.6 million, an increase of approximately 7% over the three months ended March 31, 2014. The increase in revenue was due to increased demand across all regions, North America, Asia Pacific, and EMEA (Europe, Middle East, and Africa). The increase is mainly attributable to growth in demand

Table of Contents

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

for our microphone products, other professional audio, and video products, partially offset by a decline in unified communications products revenue.

The net change in deferred revenue during the three months ended March 31, 2015 from December 31, 2014 and March 31, 2014 from December 31, 2013 was a net decrease in deferred revenue of \$320 thousand and a net decrease in deferred revenue of \$51 thousand, respectively. See "Critical Accounting Policies and Estimates" under "Revenue and Associated Allowance for Revenue Adjustments and Doubtful Accounts" below for a detailed discussion of deferred revenue.

Costs of Goods Sold and Gross Profit

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

Our gross profit margin (GPM), which is gross profit as a percentage of revenue, was 62% and 61% for the three months ended March 31, 2015 and 2014, respectively. The 1% increase in gross margin was primarily due to increased sales of higher margin products.

Operating Expenses

Operating expenses for the three months ended March 31, 2015 decreased by approximately \$0.3 million to \$6.6 million compared to \$6.9 million for the three months ended March 31, 2014.

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

S&M expenses of approximately \$2.6 million for the three months ended March 31, 2015 decreased \$115 thousand, or 4%, when compared to S&M expenses of approximately \$2.7 million for the three months ended March 31, 2014 this decreased primarily due to decreases in commission and bonus payments to employees, and decreased marketing expenses.

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

R&D expenses of approximately \$1.9 million for the three months ended March 31, 2015 decreased by \$300 thousand, or 13%, when compared to R&D expenses of approximately \$2.2 million for the three months ended March 31, 2014. R&D expenses decreased due to decreased R&D project related cost.

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

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G&A expenses of approximately \$2.0 million for the three months ended March 31, 2015 increased by \$32 thousand, or 2%, when compared to G&A expenses of approximately \$2.0 million for the three months ended March 31, 2014. G&A expenses increased due to increases in amortization of intangibles, and audit and accounting fees. These increases were partially offset by decreases in legal fees and acquisition related expenses.

We continue to incur legal expenses due to various legal proceedings explained in detail in our Form 10-K for the year ended December 31, 2014.

Other income (expense), net

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

Provision for income taxes

15

Table of Contents

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

During the three months ended March 31, 2015, we accrued income taxes at the forecasted effective tax rate of 35.8% as compared to the forecasted effective tax rate of 35.0% used during the three months ended March 31, 2014. The 0.8% increase in the forecasted effective tax rate was primarily due to changes in the amount of projected foreign income taxed at different rates. In addition, a discrete tax expense of \$2 is primarily attributable to interest and penalties related to unrecognized tax benefits.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2015, our cash and cash equivalents were approximately \$10.9 million, an increase of approximately \$3.5 million compared to cash and cash equivalents of approximately \$7.4 million as of December 31, 2014.

Net cash provided by operating activities was \$2.8 million during the three months ended March 31, 2015, a decrease in cash flow of approximately \$0.7 million compared to \$3.6 million of cash provided by operating activities during the three months ended March 31, 2014. The decrease in operating cash flow was primarily due to an increase in income taxes paid in the first quarter of 2015 with the remaining differences due to the timing of receipts and payments of working capital, which include accounts receivable, accounts payable, accrued expenses, inventories, and prepaid expenses and other assets.

Net cash provided by investing activities was approximately \$0.7 million during the three months ended March 31, 2015, a comparative net inflow of cash of approximately \$14.9 million when compared to \$14.2 million of cash used in investing activities during the three months ended March 31, 2014. Net cash provided by investing activities during the three months ended March 31, 2015 included proceeds from maturities and sales of marketable investment securities in excess of purchases of marketable securities. Net cash used in investing activities for the three months ended March 31, 2014 included payments relating to the acquisition of the business of Sabine for \$8.1 million and payments relating to the acquisition of the Spontania product line of \$5.1 million.

Net cash provided by financing activities was approximately \$27 thousand during the three months ended March 31, 2015, a decrease of approximately \$1.0 million when compared to \$1.1 million of cash provided by investing activities during the three months ended March 31, 2014. Financing activities in the first quarter of 2015 primarily consisted of cash inflows of about \$20 thousand from the exercise of stock options, while financing activities in the same period in 2014 consisted mostly of cash inflows of about \$1.0 million from the exercise of stock options.

As of March 31, 2015, our working capital was \$36.2 million as compared to \$34.0 million as of December 31, 2014.

We believe that our current cash balance, future income from operations and effective management of working capital will provide the liquidity needed to meet our short-term and long-term operating requirements and finance our growth plans. We also believe that our strong financial position and sound business structure will enable us to raise additional capital when needed to meet our short and long-term financing needs. In addition to recent acquisitions and capital expenditures, we may use cash in the near future for selective infusions of technology, sales & marketing, infrastructure, and other investments to fuel our growth, as well as acquisitions that may strategically fit our business and are accretive to our performance. We also plan to fund the payment of cash dividends in connection with the current Board approved plan as announced on December 2, 2014, which may be adjusted from time-to-time based on factors that the Board of Directors deems relevant.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our results of operations and financial position are based upon our consolidated financial statements, which have been prepared in conformity with U.S. generally accepted accounting principles. We review the accounting policies used in reporting our financial results on a regular basis. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We evaluate our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluations. We believe that the estimates we use are reasonable; however, actual results could differ from those estimates.

Our significant accounting policies are described in Note 1 of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2014. We believe the policies described below identify our most critical accounting policies, which are the policies that are both important to the representation of our financial condition

16

Table of Contents

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

and results and require our most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

Revenue and Associated Allowances for Revenue Adjustments and Doubtful Accounts

Included in continuing operations is product revenue, primarily from product sales to distributors, dealers, and end-users. Product revenue is recognized when (i) the products are shipped and any right of return expires, (ii) persuasive evidence of an arrangement exists, (iii) the price is fixed and determinable, and (iv) collection is reasonably assured.

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

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

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

The amount of deferred cost of goods sold was included in consigned inventory. The following table details the amount of deferred revenue, cost of goods sold, and gross profit as of March 31, 2015 and December 31, 2014:

| | March 31, 2015 | December 31, 2014 |
|-----------------------------|----------------|-------------------|
| Deferred revenue | \$4,684 | \$5,004 |
| Deferred cost of goods sold | 1,540 | 1,698 |
| Deferred gross profit | \$3,144 | \$3,306 |

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

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

Impairment of Goodwill and Intangible Assets

Goodwill is measured as the excess of the cost of acquisition over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. We perform impairment tests of goodwill and intangible assets with indefinite useful lives on an annual basis in the fourth fiscal quarter, or sooner if a triggering event occurs suggesting possible impairment of the values of these assets. There were no impairments recorded in 2015 or 2014 as no impairment indicators

Table of Contents

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

existed. However, due to uncertainty in the industrial, technological, and competitive environments in which we operate, we might be required to exit or dispose of the assets acquired through our acquisitions, which could result in an impairment of goodwill and intangible assets.

Impairment of Long-Lived Assets

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

Accounting for Income Taxes

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

To the extent we establish a valuation allowance in a period, we must include and expense the allowance within the tax provision in the consolidated statement of operations. In accordance with ASC Topic 740, "Accounting for Income Taxes", we analyzed our valuation allowance at December 31, 2014 and determined that based upon available evidence it is more likely than not that certain of our deferred tax assets related to capital loss carryovers, state research and development credits, and foreign net operating loss carryforwards will not be realized and, accordingly, we have recorded a valuation allowance against these deferred tax assets in the amount of \$786 thousand.

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

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

We perform a quarterly analysis of obsolete and slow-moving inventory to determine if any inventory needs to be written down. In general, we write down our excess and obsolete inventory by an amount that is equal to the difference between the cost of the inventory and its estimated market value if market value is less than cost, based upon assumptions about future product life-cycles, product demand, shelf life of the product, inter-changeability of the product and market conditions. Those items that are found to have a supply in excess of our estimated current demand are considered to be slow-moving or obsolete and classified as long-term. An appropriate reserve is made to write

down the value of that inventory to its expected realizable value. These charges are recorded in cost of goods sold. The reserve against slow-moving or obsolete inventory is increased or reduced based on several factors which, among other things, require us to make an estimate of a product's life-cycle, potential demand and our ability to sell these products at estimated price levels. While we make considerable efforts to calculate reasonable estimates of these variables, actual results may vary. If there were to be a sudden and significant decrease in demand for our products, or if there were a higher incidence of inventory obsolescence because of changing technology and customer requirements, we could be required to increase our inventory allowances and our gross profit could be adversely affected.

Share-Based Compensation

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

Table of Contents

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

liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments.

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

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

Recent Accounting Pronouncements:

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for the Company on January 1, 2017. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the consolidated financial statements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

Item 4. CONTROLS AND PROCEDURES

An evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of March 31, 2015 was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based on this evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures are effective as of March 31, 2015 to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported as specified in the SEC's rules and forms.

There was no change in our internal control over financial reporting during the quarter ended March 31, 2015 that materially affected, or that we believe is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

CLEARONE, INC.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

There are no updates to the status of the legal proceedings and commitments and contingencies reported in our Form 10-K for the year ended December 31, 2014 under Part I, Item 3. Legal Proceedings and Note 8 - Commitments and Contingencies of the Notes to Consolidated Financial Statements (Part II, Item 8).

Item 1A. RISK FACTORS

Not applicable.

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

Not applicable.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

Not applicable.

Item 6. EXHIBITS

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

Table of Contents
CLEARONE, INC.

SIGNATURES

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

ClearOne, Inc.,
(Registrant)

May 15, 2015

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

May 15, 2015

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