

CLEARONE COMMUNICATIONS INC  
Form 10-Q  
May 15, 2012

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

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2012

or

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

For the transition period \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-33660

**CLEARONE COMMUNICATIONS, INC.**

(Exact name of registrant as specified in its charter)

**Utah**

**87-0398877**

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(State or other jurisdiction of incorporation or organization)

(I.R.S. employer identification number)

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

**84116**

(Address of principal executive offices)

(Zip Code)

**(801) 975-7200**

(Registrant's telephone number, including area 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:**

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 9,098,215 shares issued and outstanding as of May 11, 2012.



**CLEARONE COMMUNICATIONS, INC.**

**QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2012**

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**PART I – FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****CLEARONE COMMUNICATIONS, INC.****CONSOLIDATED BALANCE SHEETS**

(Dollars in thousands, except par value)

	<b>Unaudited</b> As of March 31, 2012	<b>Audited</b> As of December 31, 2011
<b>ASSETS</b>		
Current assets:	\$	\$
Cash and cash equivalents	10,577	16,683
Receivables, net of allowance for doubtful accounts of \$68 and \$149, respectively	7,100	8,457
Inventories	14,475	12,565
Deferred income taxes	3,025	2,987
Prepaid expenses and other assets	1,846	740
Total current assets	37,023	41,432
Long-term inventories, net	2,449	1,905
Property and equipment, net	2,210	2,338
Intangibles, net	6,063	2,690
Goodwill	1,939	1,153
Other assets	67	41
	\$	\$
Total assets	49,751	49,559
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	1,830	2,814
Accrued liabilities	2,753	2,534
Deferred product revenue	3,822	3,404
Total current liabilities	8,405	8,752
Deferred income taxes	129	101
Deferred rent	486	494

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Other long-term liabilities	563	548
Total liabilities	9,583	9,895
Shareholders' equity:		
Common stock, par value \$0.001, 50,000,000 shares authorized, 9,098,152 shares issued and outstanding	9	9
Additional paid-in capital	40,124	40,073
Retained earnings (accumulated deficit)	35	(418)
Total shareholders' equity	40,168	39,664
	\$	\$
Total liabilities and shareholders' equity	49,751	49,559

*See accompanying notes*

## CLEARONE COMMUNICATIONS, INC.

## UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)

	<b>Three months ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	\$	\$
Revenue	10,154	10,701
Cost of goods sold	4,046	4,399
Gross profit	6,108	6,302
Operating expenses:		
Sales and marketing	2,134	1,983
Research and product development	2,008	1,637
General and administrative	1,505	1,472
Proceeds from litigation	(250)	-
Total operating expenses	5,397	5,092
Operating income	711	1,210
Other income, net	16	11
Income before income taxes	727	1,221
Provision for income taxes	274	409
	\$	\$
Net income	453	812
	\$	\$
Basic earnings per common share	0.05	0.09
	\$	\$
Diluted earnings per common share	0.05	0.09
Basic weighted average shares outstanding	9,098,152	8,931,504
Diluted weighted average shares outstanding	9,246,310	9,122,671

*See accompanying notes*





## CLEARONE COMMUNICATIONS, INC.

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	<b>Three months ended March</b>	
	<b>31,</b>	
	<b>2012</b>	<b>2011</b>
	\$	\$
Cash flows from operating activities:		
Net income	453	812
Adjustments to reconcile net income to net cash provided by (used in) operations:		
Depreciation and amortization expense	337	295
Stock-based compensation	51	39
Provision for doubtful accounts	(59)	(58)
Increase (decrease) in reserves against inventory	90	(214)
Changes in operating assets and liabilities:		
Accounts receivable	1,416	1,396
Inventories	(2,224)	(379)
Deferred income taxes	(10)	117
Prepaid expenses and other assets	(1,132)	(54)
Accounts payable	(984)	1,082
Income taxes payable	(89)	121
Accrued liabilities	309	(1,269)
Deferred product revenue	418	258
Other long-term assets and liabilities	15	53
Net cash provided by (used in) operating activities	(1,409)	2,199
Cash flows from investing activities:		
Payment towards acquisition of VCON business	(4,632)	-
Purchase of property and equipment	(65)	(175)
Net cash used in investing activities	(4,697)	(175)
Cash flows from financing activities:		
Proceeds from the issuance of common stock - options	-	21
Net cash provided by financing activities	-	21
Net increase (decrease) in cash and cash equivalents	(6,106)	2,045
Cash and cash equivalents at the beginning of the period	16,683	11,431
	\$	\$
Cash and cash equivalents at the end of the period	10,577	13,476

Supplemental disclosure of cash flow information:

	\$	\$	
Cash paid for interest		-	-
	\$	\$	
Cash paid for income taxes		1,378	-

*See accompanying notes*

**CLEARONE COMMUNICATIONS, INC.**

**UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Dollars in thousands)**

The Company acquired the business of VCON Video Conferencing, Ltd. and recorded the following assets and liabilities:

	\$	
Inventory		320
Property and equipment		34
Product warranty liability		(8)
Tradename		500
Patents and technological know-how		2,300
Proprietary software		500
In-process research and development		200
Goodwill		786
	\$	
Cash paid		4,632

*See accompanying notes*

**CLEARONE COMMUNICATIONS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited – Dollars in thousands)**

**1. Basis of Presentation**

The fiscal year for ClearOne Communications, Inc. and its subsidiaries (collectively, “ClearOne” or the “Company”) is the 12 months ending on December 31st. The consolidated financial statements include the accounts of ClearOne and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

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

**2. Business Combination**

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

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

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

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

	\$	
Inventory		320
Property and equipment		34
Product warranty liability		(8)
Tradename		500
Patents and technological know-how		2,300
Proprietary software		500
In-process research and development		200
Goodwill		786
	\$	
		4,632

**CLEARONE COMMUNICATIONS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited – Dollars in thousands)**

The Company incurred \$187 towards acquisition related expenses, all of which are categorized under General and administrative expenses in the Consolidated Statement of Operations for the period ended March 31, 2012.

Supplemental Pro Forma information

1)

Revenue and net loss from VCON business from February 16, 2012 to March 31, 2012 was \$77 and (\$152) respectively.

2)

Revenue and earnings of the combined entity as though the business combination occurred as of January 1, 2011:

	<b>Three months ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	\$	\$
Revenue	10,367	10,803
Earnings	409	647
Basic and diluted earnings per common share	0.04	0.07

3)

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

**3. Goodwill and Intangibles**

*Goodwill*

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

The goodwill balance of \$786 related to the acquisition of VCON business is deductible for tax purposes.

***Intangible Assets***

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

	<b>Estimated useful lives</b>	<b>As of March 31, 2012</b>	<b>As of December 31, 2011</b>
		\$	\$
Tradename	7 years	935	435
Patents and technological Know-how	10 years	4,370	2,070
Proprietary software	3 to 5 years	894	394
In-process research and development	Indefinite	759	559
Other	5	49	49
		7,007	3,507
Accumulated Amortization		(944)	(817)
		\$	\$
		6,063	2,690

During the three months ended March 31, 2012 and 2011, amortization of intangible assets were \$127 and \$88, respectively.





## CLEARONE COMMUNICATIONS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited – Dollars in thousands)

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

**Years ending December 31,**

	\$	
2012	635	
2013	799	
2014	782	
2015	598	
2016	560	
2017	508	
Thereafter	1,422	
	\$	
		5,304

**4. Inventories**

Inventories, net of reserves, consisted of the following:

	As of	As of
	March 31, 2012	December 31, 2011
Current:	\$	\$
Raw materials	927	1,091
Finished goods	13,548	11,474
	\$	\$
	14,475	12,565
Long-term:	\$	\$
Raw materials	827	444

Finished goods		1,622	1,461
	\$	\$	
		2,449	1,905

Long-term inventory represents inventory held in excess of our current 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 \$1,441 and \$1,199 as of March 31, 2012 and December 31, 2011, respectively. Consigned inventory represents inventory at distributors and other customers where revenue recognition criteria have not been achieved.

During the three months ended March 31, 2012, losses amounting to \$90 were incurred on valuation of inventory at lower of cost or market value and write-off of obsolete inventory.

## 5. Share-based Compensation

Share-based compensation expense has been allocated as follows:

	<b>Three months ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	\$	\$
Cost of goods sold	1	-
Sales and marketing	13	4
Research and development	7	4
General and administrative	30	31
	\$	\$
	51	39

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

As of March 31, 2012 the total remaining unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately \$530.

During the three months ended March 31, 2012 and 2011, we granted 30,000 and 0 stock options respectively. We use judgment in determining the fair value of the share-based payments on the date of grant using an option-pricing model with assumptions regarding a number of highly complex and subjective variables. These variables include the risk-free interest rate of the awards, the expected life of the awards, the expected volatility over the term of the awards, the expected dividends of the awards, and an estimate of the amount of awards that are expected to be forfeited. We use the Black-Scholes option pricing model to determine the fair value of share-based payments granted under ASC Topic 718.

**6. Shareholders' Equity**

The following table summarizes the change in shareholders' equity during the three months ended March 31, 2012 and 2011, respectively:

	<b>Three months ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
	\$	\$
Balance at the beginning of the period	39,664	31,735
Net income during the period	453	812
Stock based compensation	51	39
Exercise of stock options	-	21
	\$	\$
Balance at end of the period	40,168	32,607

**7. Proceeds from litigation**

During the three months ended March 31, 2011, \$250 was received as a settlement of amounts due from a defendant in our litigation related to the "Theft of ClearOne's Intellectual Property and related cases" described in detail in Form 10-K for the year ended December 31, 2011.

## **8. Income Taxes**

The total outstanding balance for liabilities related to unrecognized tax benefits at March 31, 2012 was approximately \$563, of which \$35 was associated with interest and penalties. We account for interest expense and penalties for unrecognized tax benefits as part of our income tax provision.

Accrued liabilities as of March 31, 2012 and December 31, 2011 include accrued income taxes payable of \$211 and \$300, respectively.

## **9. Commitments and Contingencies**

The Company entered in to a consulting arrangement for a period of 12 months. The consulting arrangement provides for a fixed fee of approximately \$180 with additional maximum incentive-based fees of approximately \$20 associated with accomplishing specific milestones.

## **10. Subsequent Events**

The Company evaluated its consolidated financial statements as of and for the three months ended March 31, 2012 for subsequent events through the date the financial statements were issued. The Company is not aware of any subsequent event which would require recognition or disclosure in the financial statements.

**CLEARONE COMMUNICATIONS, INC.**

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

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

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

**Business Overview**

We are a global communications solutions company that develops and sells conferencing, collaboration, and streaming multimedia systems for audio, video, and web applications. The reliability, flexibility and performance of our advanced and comprehensive solutions enhance the quality of life through better communication, education, and entertainment.

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

NetStreams® DigilinX, the ClearOne brand for residential multimedia streaming and control, and VIEW™, the ClearOne brand for commercial multimedia streaming and control, deliver a superior IP A/V experience by streaming high definition audio and video (multimedia) and control over TCP/IP LAN networks.

NetStreams' technology is used in a wide variety of applications including digital signage, corporate video streaming, network operations centers, distance education, and in venues for hospitality and entertainment as well as casinos.

**CLEARONE COMMUNICATIONS, INC.**

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

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

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

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

Our business goals are to:

.

Leverage on the streaming, digital signage and video conference technologies we acquired recently to enter new growth markets.

.

Maintain our global market share leadership of professional audio conferencing products for large businesses and organizations;

.

Focus on the small and medium business (SMB) market with scaled, lower cost and less complex products and solutions;

.

Capitalize on the growing adoption of unified communications and introduce new products by entering Information Technology channels;

.

Partner with large enterprise communications providers worldwide to bring value added products to their solution portfolios and channels;

.

Capitalize on emerging market opportunities as audio video, information technology, unified communications and traditional digital signage converge to meet enterprise and commercial multimedia needs; and

.

Expand and strengthen sales channels

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

Our revenues were \$10.2 million and \$10.7 million during the quarters ended March 31, 2012 and 2011, respectively. Our gross profit decreased by \$194,000 during the quarter ended March 31, 2012 compared to the quarter ended March 31, 2011. Net income decreased to \$453,000 during the quarter ended March 31, 2012 compared to net income of \$812,000 during the quarter ended March 31, 2011. The decrease in revenues was primarily due to a decline in revenue from EMEA and softer sales in the Americas. Net income declined due to reduced revenue, added costs due to acquisitions and higher research and development spending.



## CLEARONE COMMUNICATIONS, INC.

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

We expect the recent acquisitions and new product introductions to start contributing to revenue in the near future. The prospects of growth in both revenues and profits in the near future would depend on the strength of the global economy, especially the recovery of European markets. We continue to monitor closely the global economic events and continue our existing measures to control costs and invest in strategic products and initiatives.

A detailed discussion of our results of operations follows below.

## Analysis of Results of Operations

*Results of Operations for the quarter ended March 31, 2012 and 2011*

The following table sets forth certain items from our unaudited condensed consolidated statements of operations (dollars in thousands) for the quarters ended March 31, 2012 and 2011 respectively, together with the percentage of total revenue which each such item represents:

	Quarter ended March 31,				Variance	
	2012		2011		Favorable (Unfavorable)	
	Amount	% of Revenue	Amount	% of Revenue	Amount	
	\$		\$		\$	
Revenue	10,154	100.0%	10,701	100.0%	(547)	-5.1%
Cost of goods sold	4,046	39.8%	4,399	41.1%	353	8.0%
Gross profit	6,108	60.2%	6,302	58.9%	(194)	-3.1%
Sales and marketing	2,134	21.0%	1,983	18.5%	(151)	-7.6%
Research and product development	2,008	19.8%	1,637	15.3%	(371)	-22.7%
General and administrative	1,505	14.8%	1,472	13.8%	(33)	-2.2%
Proceeds from litigation	(250)	-2.5%	-	-	250	100.0%
Operating income	711	7.0%	1,210	11.3%	(499)	-41.2%
Other income, net	16	0.2%	11	0.1%	5	45.5%
Income before income taxes	727	7.2%	1,221	11.4%	(494)	-40.5%
Provision for income taxes	274	2.7%	409	3.8%	135	33.0%
	\$		\$		\$	
Net income	453	4.5%	812	7.6%	(359)	-44.2%

***Revenue***

Revenue for the quarter ended March 31, 2012 (“2012 Q1”) decreased by approximately 5% over the quarter ended March 31, 2011 (“2011 Q1”). The decrease in revenue affected all product categories and was primarily caused by the economic uncertainty in the European markets due to debt crisis, lower demand from the government sector in North America and slowdown in Asian markets.

During 2012 Q1 and 2011 Q1, the net change in deferred revenue was a net deferral of revenue of \$418,000 and \$258,000 respectively. See “Critical Accounting Policies and Estimates” under “Revenue and Associated Allowance for Revenue Adjustments and Doubtful Accounts” below for a detailed discussion of deferred revenue.

***Costs of Goods Sold and Gross Profit***

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

Our gross profit margin, which is gross profit as a percentage of revenue, was 60% and 59% in 2012 Q1 and 2011 Q1, respectively.

**CLEARONE COMMUNICATIONS, INC.**

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

*Operating Expenses*

2012 Q1 operating expenses excluding litigation proceeds of \$250,000 were approximately \$5.6 million, an increase of approximately \$555,000 from \$5.1 million in 2011 Q1 or an increase of 11%. The litigation proceeds of \$250,000 represents a receipt of a settlement of amounts due from a defendant in our litigation related to the "Theft of ClearOne's Intellectual Property and related cases" described in detail in Form 10-K for the year ended December 31, 2011.

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

S&M expenses during 2012 Q1 increased by approximately \$151,000, or 8%, when compared to 2011 Q1. The increase in S&M expenses during 2012 Q1 was primarily due to increased employee-related costs due to added headcount consequent to recent acquisitions and increased marketing expenses partially offset by a reduction in commissions to independent sales agents.

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

R&D expenses during 2012 Q1 increased by \$371,000, or 23%, compared to R&D expenses during 2011 Q1. The decrease was primarily due to increases in employee-related costs due to recent acquisitions and project related costs.

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

G&A expenses during 2012 Q1 increased by \$33,000, or 2%, compared to expenses during 2011 Q1. The increase was primarily due to increased legal costs related to the acquisition of the business of VCON, amortization of intangibles and bank fees partially offset by reduction in executive bonus, recruitment costs and consulting expenses.

We continue to incur high legal expenses due to various litigation issues explained in detail in Form 10-K for the year ended December 31, 2011.

***Other income (expense), net***

Other income (expense), net, includes interest income, interest expense, gain (loss) on the disposal of assets, and currency gain (loss).

***Provision for income taxes***

During 2012 Q1, we accrued income taxes at the expected annualized rate of 37.7% as compared to annualized rate of 33.5% in 2011 Q1. The increase in the expected annualized rate in 2012 Q1 was primarily due to the expiration of federal R&D credit on December 31, 2011.

**Liquidity and Capital Resources**

As of March 31, 2012, our cash and cash equivalents were approximately \$10.6 million, a decrease of \$6.1 million compared to cash and cash equivalents of approximately \$16.7 million as of December 31, 2011.

**CLEARONE COMMUNICATIONS, INC.**

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

Net cash used in operating activities was \$1.4 million in 2012 Q1, a decrease of approximately \$3.6 million compared to \$2.2 million cash provided by operating activities in 2011 Q1. The decrease was primarily due to increases in inventories and prepaid expenses and a decrease in accounts payable partially offset by a decrease in accounts receivables.

Net cash used in investing activities in 2012 Q1 was approximately \$4.7 million, which consisted of the acquisition of the business of VCON for \$4.6 million and \$65,000 towards purchases of equipment. Net cash used in investing activities in 2011 Q1 consisted of the purchase of equipment of approximately \$175,000.

As of March 31, 2012 our working capital was \$28.6 million as compared to \$32.7 million as of December 31, 2011.

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

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

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

***Revenue and Associated Allowances for Revenue Adjustments and Doubtful Accounts***

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

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

## CLEARONE COMMUNICATIONS, INC.

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

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

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

	<b>As of</b>	
	<b>March 31, 2012</b>	<b>December 31, 2011</b>
	\$	\$
Deferred Revenue	3,822	3,404
Deferred Cost of Goods Sold	1,441	1,199
	\$	\$
Deferred Gross Profit	2,381	2,205

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

We offer credit terms on the sale of our products to a majority of our customers and perform ongoing credit evaluations of our customers' financial condition. We maintain an allowance for doubtful accounts for estimated losses

resulting from the inability or unwillingness of our customers to make required payments based upon our historical collection experience and expected collectability of all accounts receivable. Our actual bad debts in future periods may differ from our current estimates and the differences may be material, which may have an adverse impact on our future accounts receivable and cash position.

### ***Impairment of Goodwill and Intangible Assets***

We allocated the purchase price of our acquisition of NetStreams, Inc. and the business of Magic Box, Inc. on the basis of well established valuation techniques performed by qualified experts. The purchase price towards the acquisition of the business of VCON Video Conferencing, Ltd. has been allocated on a provisional basis pending full expert valuation. Goodwill is measured as the excess of the fair value of acquisition consideration over the sum of the fair values of tangible and identifiable intangible assets acquired less liabilities assumed. We intend to perform impairment tests of goodwill and intangible assets with an indefinite useful life, on an annual basis in the fourth fiscal quarter, or sooner if a triggering event occurs suggesting possible impairment of the values of these assets. As of March 31, 2012, \$1.9 million and \$759,000 have been recorded as goodwill and intangible assets with an indefinite useful life, respectively.

In response to changes in industry, technology and competitive circumstances we might be required to exit or dispose of the acquired businesses, 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.



**CLEARONE COMMUNICATIONS, INC.**

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

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset or asset group to estimated future undiscounted net cash flows of the related asset or group of assets over their remaining lives. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment charge is recognized for the amount by which the carrying amount exceeds the estimated fair value of the asset. Impairment of long-lived assets is assessed at the lowest levels for which there are identifiable cash flows that are independent of other groups of assets. The impairment of long-lived assets requires judgments and estimates. If circumstances change, such estimates could also change. Assets held for sale are reported at the lower of the carrying amount or fair value, less the estimated costs to sell.

***Accounting for Income Taxes***

We are subject to income taxes in both the United States and in certain non-U.S. jurisdictions. We estimate our current tax position together with our future tax consequences attributable to temporary differences resulting from differing treatment of items, such as deferred revenue, depreciation, and other reserves for tax and accounting purposes. These temporary differences result in deferred tax assets and liabilities. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income, prior year carryback, or future reversals of existing taxable temporary differences. To the extent we believe that recovery is not more likely than not, we establish a valuation allowance against these deferred tax assets. Significant judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against our deferred tax assets. To the extent we establish a valuation allowance in a period we must include and expense the allowance within the tax provision in the consolidated statement of operations. Our valuation allowance at March 31, 2012 is \$1.2 million.

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

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

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

if there were a higher incidence of inventory obsolescence because of changing technology and customer requirements, we could be required to increase our inventory reserves, and our gross profit could be adversely affected.

***Share-Based Payment***

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

**CLEARONE COMMUNICATIONS, INC.**

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

In December 2004, the FASB issued guidelines now contained under FASB ASC Topic 718, *Compensation – Stock Compensation*. ASC Topic 718 establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. Primarily, this Topic focuses on accounting for transactions in which an entity obtains employee services in share-based payment transactions. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Under ASC Topic 718, we measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the awards – the requisite service period (usually the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service. Therefore, if an employee does not ultimately render the requisite service, the costs associated with the unvested options will not be recognized cumulatively.

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

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



**CLEARONE COMMUNICATIONS, INC.**

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

**Item 4. CONTROLS AND PROCEDURES**

An evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of March 31, 2012 was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based on this evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures are effective as of March 31, 2012 to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported as specified in the SEC's rules and forms.

There was no change in our internal control over financial reporting during the quarter ended March 31, 2012 that materially affected, or that we believe is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

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

***Former Officer Indemnification***

On April 30, 2012, the Tenth Circuit denied ClearOne's writ of mandamus on the grounds that ClearOne's request for restitution should be reviewed on appeal after entry of a final order by the District Court.

**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.



**CLEARONE COMMUNICATIONS, INC.**

**Item 6. EXHIBITS**

<b><u>Exhibit No.</u></b>	<b><u>Title of Document</u></b>
2.1	Asset purchase agreement between ClearOne Communications Hong Kong Limited, C-V Private (Israel) Ltd. and VCON Video Conferencing, Ltd.
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Principal Financial Officer
32.1	Section 906 Certification of Chief Executive Officer
32.2	Section 906 Certification of Principal Financial Officer
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definitions Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

**SIGNATURES**

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

ClearOne Communications, Inc.,

(Registrant)

May 14, 2012

By: /s/ Zeynep Hakimoglu  
Zeynep Hakimoglu

Chief Executive Officer

*(Principal Executive Officer)*

May 14, 2012

By: /s/ Narsi Narayanan  
Narsi Narayanan



Vice President of Finance

*(Principal Financial and Accounting Officer)*