

CLEARONE INC
Form 10-Q
November 09, 2016

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 September 30, 2016

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)

87-0398877

(I.R.S. employer identification number)

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

(Address of principal executive offices)

84116

(Zip Code)

+1 (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:

The number of shares of ClearOne common stock outstanding as of November 4, 2016 was 8,875,659.

CLEARONE, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2016

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Table of Contents**PART I – FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****CLEARONE, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(Dollars in thousands, except par value)**

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,273	\$ 13,412
Marketable securities	7,060	7,161
Receivables, net of allowance for doubtful accounts of \$49 and \$54, respectively	8,483	8,692
Inventories, net	11,991	13,447
Distributor channel inventories	1,538	1,628
Prepaid expenses and other assets	2,216	1,806
Total current assets	43,561	46,146
Long-term marketable securities	20,721	19,204
Long-term inventories, net	1,753	2,018
Property and equipment, net	1,409	1,589
Intangibles, net	5,902	6,638
Goodwill	12,724	12,724
Deferred income taxes	5,093	5,093
Other assets	117	117
Total assets	\$ 91,280	\$ 93,529
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 3,587	\$ 2,815
Accrued liabilities	2,085	2,243
Deferred product revenue	4,271	4,549
Total current liabilities	9,943	9,607
Deferred rent	122	150
Other long-term liabilities	1,260	1,203
Total liabilities	11,325	10,960
Shareholders' equity:		
Common stock, par value \$0.001, 50,000,000 shares authorized, 8,892,042 and 9,183,957 shares issued and outstanding	9	9
Additional paid-in capital	46,455	46,291

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Accumulated other comprehensive income (loss)	32	(166)
Retained earnings	33,459	36,435
Total shareholders' equity	79,955	82,569
Total liabilities and shareholders' equity	\$ 91,280	\$ 93,529

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 September 30,		Nine months ended September 30,		
	2016	2015	2016	2015	
Revenue	\$12,908	\$15,913	\$37,907	\$43,513	
Cost of goods sold	5,240	5,725	14,110	15,873	
Gross profit	7,668	10,188	23,797	27,640	
Operating expenses:					
Sales and marketing	2,389	2,752	7,695	8,126	
Research and product development	2,116	2,132	6,481	6,128	
General and administrative	1,739	1,796	4,904	5,686	
Total operating expenses	6,244	6,680	19,080	19,940	
Operating income	1,424	3,508	4,717	7,700	
Other income, net	100	54	194	244	
Income before income taxes	1,524	3,562	4,911	7,944	
Provision for income taxes	315	1,145	1,379	2,740	
Net income	\$1,209	\$2,417	\$3,532	\$5,204	
Basic earnings per common share	\$0.14	\$0.26	\$0.39	\$0.57	
Diluted earnings per common share	\$0.13	\$0.25	\$0.37	\$0.54	
Basic weighted average shares outstanding	8,921,480	9,139,329	9,076,305	9,119,925	
Diluted weighted average shares outstanding	9,164,165	9,615,684	9,452,616	9,583,951	
Comprehensive income:					
Net income	\$1,209	\$2,417	\$3,532	\$5,204	
Other comprehensive income:					
Change in unrealized gains (losses) on available-for-sale securities, net of tax	(39) 17	179	(5)
Change in foreign currency translation adjustment	7	(8) 19	(59)
Comprehensive income	\$1,177	\$2,426	\$3,730	\$5,140	

See accompanying notes

Table of Contents**CLEARONE, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Dollars in thousands)**

	Nine months ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$3,532	\$5,204
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization expense	1,408	1,551
Amortization of deferred rent	(57)	(70)
Stock-based compensation expense	494	648
Provision for (recoveries of) doubtful accounts, net	(6)	(7)
Write-down of inventory to net realizable value	458	396
Loss on disposal of assets	54	—
Tax benefit from exercise of stock options	(721)	(49)
Deferred income taxes	107	(2)
Changes in operating assets and liabilities:		
Receivables	234	552
Inventories	1,353	(1,478)
Prepaid expenses and other assets	(147)	635
Accounts payable	770	(553)
Accrued liabilities	(134)	(635)
Income taxes payable	429	1,006
Deferred product revenue	(284)	(183)
Other long-term liabilities	(51)	(605)
Net cash provided by operating activities	7,439	6,410
Cash flows from investing activities:		
Purchase of property and equipment	(544)	(98)
Proceeds from maturities and sales of marketable securities	5,371	5,102
Purchases of marketable securities	(6,608)	(5,987)
Net cash provided by (used in) investing activities	(1,781)	(983)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	736	274
Repurchase and cancellation of stock options	(1,752)	—
Tax benefits from exercise of stock options	721	49
Dividends paid	(1,373)	(639)
Repurchase and cancellation of stock	(5,139)	—
Net cash used in financing activities	(6,807)	(316)

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Effect of exchange rate changes on cash and cash equivalents	10	(64)
Net increase (decrease) in cash and cash equivalents	(1,139)	5,047
Cash and cash equivalents at the beginning of the period	13,412	7,440
Cash and cash equivalents at the end of the period	\$12,273	\$12,487

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CLEARONE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

The following is a summary of supplemental cash flow activities:

	Nine months ended September 30, 2016 2015	
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$893	\$2,285

See accompanying notes

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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. together with its subsidiaries (collectively, “ClearOne” or the “Company”) is 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 unaudited condensed consolidated financial statements for the three and nine months ended September 30, 2016 and 2015, 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 condensed consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of our financial position as of September 30, 2016 and December 31, 2015, the results of operations for the three and nine months ended September 30, 2016 and 2015, and the cash flows for the nine months ended September 30, 2016 and 2015. The results of operations for the three and nine months ended September 30, 2016 and 2015 are not necessarily indicative of the results for a full-year period. These interim unaudited 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, 2015 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, 2015. There have been no changes to these policies during the nine months ended September 30, 2016 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. The updated standard becomes effective for the Company on January 1, 2018. Early adoption is permitted. 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.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740), simplifying the presentation of deferred taxes on the balance sheet by requiring companies to classify everything as either a non-current asset or non-current liability. Early adoption of this ASU is permitted. ClearOne has adopted this standard update early as it simplified the presentation of taxes on the balance sheet and within the income tax footnote.

In February 2016, FASB released Accounting Standards Update No. 2016-02, Leases (Topic 842) to bring transparency to lessee balance sheets. The ASU will require organizations that lease assets (lessees) to recognize assets and liabilities on the balance sheet for the rights and obligations created by all leases with terms of more than 12 months. The standard will apply to both types of leases—capital (or finance) leases and operating leases. Previously, GAAP has required only capital leases to be recognized on lessee balance sheets. The standard is effective for fiscal years beginning after December 15, 2018 and interim periods within fiscal years beginning after December 15, 2018. Early application will be permitted for all organizations. 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.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation: Improvements to Employee Shared-Based Payment Accounting. The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. ASU 2016-09 is effective for the Company on January 1, 2017 and we are currently evaluating the impact that ASU 2016-09 will have on our consolidated financial statements.

Table of Contents**CLEARONE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited - Dollars in thousands)**

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Measurement of Credit Losses on Financial Instruments, which requires measurement and recognition of expected credit losses for financial assets held. ASU 2016-13 is effective for the Company beginning January 1, 2020 and we are currently evaluating the impact that ASU 2016-13 will have on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments, which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. ASU 2016-15 is effective for the Company beginning January 1, 2018 and we are currently evaluating the impact that ASU 2016-15 will have on our consolidated financial statements.

2. Earnings Per Share

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

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Numerator:				
Net income	\$1,209	\$2,417	\$3,532	\$5,204
Denominator:				
Basic weighted average shares outstanding	8,921,480	9,139,329	9,076,305	9,119,925
Dilutive common stock equivalents using treasury stock method	242,686	476,355	376,312	464,026
Diluted weighted average shares outstanding	9,164,165	9,615,684	9,452,616	9,583,951
Basic earnings per common share	\$0.14	\$0.26	\$0.39	\$0.57
Diluted earnings per common share	\$0.13	\$0.25	\$0.37	\$0.54
Weighted average options outstanding	832,766	1,061,705	900,687	1,045,697
Anti-dilutive options not included in the computations	312,372	218,875	312,477	255,375

3. 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 securities at September 30, 2016 and December 31, 2015 were as follows:

	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Estimated fair value
September 30, 2016				
Available-for-sale securities:				
Corporate bonds and notes	\$ 20,566	\$ 212	\$ (17)	\$ 20,761
Municipal bonds	6,997	28	(5)	7,020
Total available-for-sale securities	\$ 27,563	\$ 240	\$ (22)	\$ 27,781

	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Estimated fair value
December 31, 2015				
Available-for-sale securities:				
Corporate bonds and notes	\$ 20,827	\$ 50	\$ (133)	\$ 20,744
Municipal bonds	5,608	18	(5)	5,621
Total available-for-sale securities	\$ 26,435	\$ 68	\$ (138)	\$ 26,365

Table of Contents**CLEARONE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited - Dollars in thousands)**

Maturities of marketable securities classified as available-for-sale securities were as follows at September 30, 2016:

	Amortized cost	Estimated fair value
September 30, 2016		
Due within one year	\$ 7,053	\$ 7,059
Due after one year through five years	19,532	19,721
Due after five years through ten years	978	1,001
Total available-for-sale securities	\$ 27,563	\$ 27,781

Debt securities in an unrealized loss position as of September 30, 2016 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 September 30, 2016 are summarized as follows:

(In thousands)	Less than 12 months		More than 12 months		Total	
	Estimated fair value	Gross unrealized holding losses	Estimated fair value	Gross unrealized holding losses	Estimated fair value	Gross unrealized holding losses
As of September 30, 2016						
Corporate bonds and notes	\$3,012	\$ (8)	\$1,841	\$ (8)	\$4,853	\$ (16)
Municipal bonds	779	(6)	315	-	1,094	(6)
	\$3,791	\$ (14)	\$2,156	\$ (8)	\$5,947	\$ (22)

4. Intangible Assets

Intangible assets as of September 30, 2016 and December 31, 2015 consisted of the following:

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	Estimated useful lives	September 30, 2016	December 31, 2015
Tradename	5 to 7 years	\$ 555	\$ 555
Patents and technological know-how	10 years	5,970	5,850
Proprietary software	3 to 15 years	4,341	4,341
Other	3 to 5 years	324	324
Total intangible assets		11,190	11,070
Accumulated amortization		(5,288)	(4,432)
Total intangible assets, net		\$ 5,902	\$ 6,638

The amortization of intangible assets for the three and nine months ended September 30, 2016 and September 30, 2015 was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Amortization of intangible assets	\$280	\$315	\$856	\$629

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

Years ending December 31,	
2016 (remainder)	\$266
2017	925
2018	851
2019	778
2020	560
Thereafter	2,523
	\$5,902

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Inventories, net of reserves, as of September 30, 2016 and December 31, 2015 consisted of the following:

	September 30, 2016	December 31, 2015
Current:		
Raw materials	\$ 2,460	\$ 2,735
Finished goods	9,289	10,712
	\$ 11,749	\$ 13,447
Long-term:		
Raw materials	\$ 477	\$ 375
Finished goods	1,276	1,643
	\$ 1,753	\$ 2,018

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, although there can be no assurance of the timing or amount of any sales.

Current finished goods do not include consigned inventory in the amounts of approximately \$1,538 and \$1,628 as of September 30, 2016 and December 31, 2015, respectively. Distributor channel inventories represent inventories 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 and nine months ended September 30, 2016 and 2015, respectively.

Three months	Nine months
-----------------	----------------

	ended September 30, 2016		ended September 30, 2015	
Net loss on valuation of inventory and write-off of obsolete inventory	\$328	\$266	\$458	\$396

6. Share-based Compensation

Employee Stock Option Plans

The Company's share-based incentive plans offering stock options primarily consists of two plans. Under both plans, one new share is issued for each stock option exercised. The plans are described below.

The Company's 1998 Incentive Plan (the "1998 Plan") was the Company's primary plan through November 2007. Under this plan shares of common stock were made available for issuance to employees and directors. Through December 1999, 1,066,000 options were granted that would cliff vest after 9.8 years; however, such vesting was accelerated for 637,089 of these options upon meeting certain earnings per share goals through the fiscal year ended September 30, 2003. Subsequent to December 1999 and through September 2002, 1,248,250 options were granted that would cliff vest after 6.0 years; however, such vesting was accelerated for 300,494 of these options upon meeting certain earnings per share goals through the fiscal year ended September 30, 2005.

The Company's 2007 Equity Incentive Plan (the "2007 Plan") was restated and approved by the shareholders on December 12, 2014. Provisions of the restated 2007 Plan include the granting of up to 2,000,000 incentive and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. Options may be granted to employees, officers, non-employee directors and other service providers and may be granted upon such terms as the Compensation Committee of the Board of Directors determines in their sole discretion.

Of the options granted subsequent to September 2002, all vesting schedules are based on 3 or 4-year vesting schedules, with either one-third or one-fourth vesting on the first anniversary and the remaining options vesting ratably over the remainder of the vesting term. Generally, directors and officers have 3-year vesting schedules and all other employees have 4-year vesting schedules. Additionally, in the event of a change in control or the occurrence of a corporate transaction, the Company's Board of Directors has the authority to elect that all unvested options shall vest and become exercisable immediately prior to the event or closing of the transaction. All options outstanding as of September 30, 2016 had contractual lives of ten years. Under the 1998 Plan, 2,500,000 shares were authorized for grant. As of September 30, 2016, there were 150,000 options outstanding under the 1998 Plan, which includes the cliff vesting and 3 or 4-year vesting options discussed above. As of September 30, 2016, there were 691,816 options outstanding under the 2007 Plan. As of September 30, 2016, the 2007 Plan had 859,410 authorized unissued options, while there were no options remaining that could be granted under the 1998 Plan.

Table of Contents**CLEARONE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited - Dollars in thousands)**

A summary of the stock option activity under the Company's plans for the nine months ended September 30, 2016 is as follows:

	Number of shares	Weighted average exercise price
Options outstanding at beginning of year	1,028,935	\$ 6.03
Granted	204,700	11.77
Less:		
Exercised	147,085	4.56
Repurchased	225,542	4.37
Canceled or Expired	19,192	11.30
Options outstanding at September 30, 2016	841,816	8.01
Options exercisable at end of September 30, 2016	537,200	\$ 6.22

As of September 30, 2016, the total remaining unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately \$1,229, which will be recognized over a weighted average period of 2.38 years.

Stock Option Repurchase: From March 11, 2016 to March 17, 2016, the Company offered to repurchase eligible vested options to purchase shares under the 1998 Plan and the 2007 Plan from employees. The Company repurchased delivered options at a repurchase price equal to the difference between the closing market price on the date of the employee's communication of accepting the repurchase offer and the exercise price of such employee's delivered options, subject to applicable withholding taxes and charges. The Company repurchased 225,542 stock options from employees at an average purchase price of \$7.77.

Employee Stock Purchase Plan

The Company issues shares to employees under the Company's 2014 Employee Stock Purchase Plan (the "ESPP"). The ESPP was approved by the Company's shareholders on December 12, 2014. As of September 30, 2016, 480,444 of the originally approved 500,000 shares were available for offerings under the ESPP. Offering periods under the ESPP

commence on each January 1 and July 1, and continue for a duration of nine months. The ESPP is available to all employees who do not own, or not are deemed to own, shares of stock making up an excess of 5% of the combined voting power of the Company, its parent or subsidiary. During each offering period, each eligible employee may purchase shares under the ESPP after authorizing payroll deductions. Under the ESPP, each employee may purchase up to the lesser of 2,500 shares or \$25 of fair market value (based on the established purchase price) of the Company's stock for each offering period. Unless the employee has previously withdrawn from the offering, his or her accumulated payroll deductions will be used to purchase common stock on the last business day of the period at a price equal to 85% (or a 15% discount) of the fair market value of the common stock on the first or last day of the offering period, whichever is lower.

Share-based compensation expense has been recorded as follows:

	Three months ended September 30, 2016		Nine months ended September 30, 2015	
Cost of goods sold	\$7	\$5	\$18	\$15
Sales and marketing	15	32	42	111
Research and product development	40	33	106	100
General and administrative	113	123	328	422
	\$175	\$193	\$494	\$648

Table of Contents**CLEARONE, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited - Dollars in thousands)****7. Shareholders' Equity**

The following table summarizes the change in shareholders' equity during the three and nine months ended September 30, 2016 and 2015, respectively:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Balance at the beginning of the period	\$79,783	\$78,665	\$82,569	\$76,016
Exercise of stock options	238	62	671	152
Stock repurchased	(1,024)	—	(5,139)	—
Options repurchased	—	—	(1,752)	—
Proceeds from stock purchase plan	21	40	65	40
Dividends	(449)	—	(1,373)	(639)
Share-based compensation	175	193	494	648
Tax benefit - stock option exercise	33	20	690	49
Unrealized gain or loss on investments, net of tax	(38)	17	179	(5)
Foreign currency translation adjustment	7	(8)	19	(59)
Net income during the period	1,209	2,417	3,532	5,204
Balance at end of the period	\$79,955	\$81,406	\$79,955	\$81,406

On August 10, 2016, the Company announced a quarterly cash dividend of \$0.05 per share which was paid on September 7, 2016 to shareholders of record as of August 24, 2016.

8. 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 September 30, 2016 and December 31, 2015:

	Level 1	Level 2	Level 3	Total
September 30, 2016				
Corporate bonds and notes	\$ —	\$20,761	\$ —	\$20,761
Municipal bonds	—	7,020	—	7,020
Total	\$ —	\$27,781	\$ —	\$27,781

	Level 1	Level 2	Level 3	Total
December 31, 2015				
Corporate bonds and notes	\$ —	\$20,744	\$ —	\$20,744
Municipal bonds	—	5,621	—	5,621
Total	\$ —	\$26,365	\$ —	\$26,365

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CLEARONE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited - Dollars in thousands)

9. Income Taxes

The Company's forecasted effective tax rate at September 30, 2016 is 32.3%, a 3.5% decrease from the 35.8% effective tax rate recorded at December 31, 2015. The forecasted effective tax rate of 32.3% 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 33.3%. 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 September 30, 2016.

After a discrete tax benefit of \$303, the effective tax rate for the quarter ended September 30, 2016 is 28.0%. The discrete tax benefit is primarily attributable to a tax benefit related to stock-based compensation and changes in estimated R&D tax credits.

10. Subsequent Events

On November 1, 2016 the Company announced a quarterly cash dividend for the fourth quarter of 2016 at \$0.05 per share to be paid on November 30, 2016 to shareholders of record as of November 16, 2016.

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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 based upon reasonable assumptions at the time made, 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, many of which we cannot predict with accuracy and some of which we might not anticipate, 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 reports filed with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2015. 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, 2015.

BUSINESS OVERVIEW

We are a global company that designs, develops and sells conferencing, collaboration, streaming and digital signage solutions for audio/voice and visual communications. The performance and simplicity of our advanced comprehensive solutions enhance the quality of life and 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 large, medium and small businesses. We occupy the number one global market share position, with more than 50% market share in the professional audio conferencing market for our products 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;

Leverage the video conferencing & collaboration, streaming and digital signage technologies 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 growing adoption of unified communications and introduce new products through emerging 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 focus on our core strengths, which include the following:

Providing a superior conferencing and collaboration experience;

Significantly impacting multimedia distribution and control;

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CLEARONE, INC.

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

Offering greater value to our customers and partners;
Leveraging and extending ClearOne technology, leadership and innovation;
Leveraging our strong domestic and international channels to distribute new products; and
Strengthening existing customer and partner relationships through dedicated support.

Our revenues were \$12.9 million and \$15.9 million during the three months ended September 30, 2016 and 2015, respectively. The revenues mainly decreased due to overall fall in demand for our products in most major markets. The revenues for three months ended September 30, 2015 also included three quarters of licensing fees reflecting the execution of a licensing agreement in Q3 of 2015 even though the fees were due from the beginning of 2015 as per the terms of the agreement. The revenues for three months ended September 30, 2015 also had the benefit of three quarters of revenue from licensing fees. Our gross profit decreased by \$2.5 million during the three months ended September 30, 2016 compared to the three months ended September 30, 2015. Gross profit declined primarily due to reduction in revenue and due to unfavorable change in product revenue and licensing fees mix. Net income decreased by \$1.2 million during the three months ended September 30, 2016 compared to the three months ended September 30, 2015. Net income for the three months ended September 30, 2016 decreased primarily due to reduction in revenues and associated gross profit, partially offset by savings due to reductions in operating expenses.

Our revenues were \$37.9 million and \$43.5 million during the nine months ended September 30, 2016 and 2015, respectively. The revenues decreased due to an overall fall in demand for our products in all major markets. Our gross profit decreased by \$3.8 million during the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015. Net income decreased by \$1.7 million during the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015. Net income for the nine months ended September 30, 2016 decreased primarily due to reduction in revenues and associated gross profit, partially offset by savings due to reductions in operating expenses.

Future revenue growth and income growth are dependent on the recovery of the global economy and the success of CONVERGE Pro 2, our new professional audio conferencing platform that we launched in June 2016 and that will replace our current generation of CONVERGE Pro products. We closely monitor the economic situation around the world and have developed sound operating and financial plans to overcome the challenges posed by the weak economy. Sequentially, our revenues for the three months ended September 30, 2016 grew approximately \$900,000, a 7.9% increase as compared to the three months ended June 30, 2016, representing the first sequential quarterly increase in revenues since the three months ended September 30, 2015.

A detailed discussion of our results of operations follows below.

Results of Operations for the three and nine months ended September 30, 2016 and 2015

The following table sets forth certain items from our unaudited condensed consolidated statements of operations (dollars in thousands) for the three and nine months ended September 30, 2016 and 2015, respectively, together with the percentage of total revenue which each such item represents:

	Three months ended September 30,				Nine months ended September 30,				
	2016	% of Revenue	2015	% of Revenue	2016	% of Revenue	2015	% of Revenue	
Revenue	\$12,908	100	% \$15,913	100	% \$37,907	100	% \$43,513	100	%
Cost of goods sold	5,240	41	% 5,725	36	% 14,110	37	% 15,873	36	%
Gross profit	7,668	59	% 10,188	64	% 23,797	63	% 27,640	64	%
Sales and marketing	2,389	19	% 2,752	17	% 7,695	20	% 8,126	19	%
Research and product development	2,116	16	% 2,132	13	% 6,481	17	% 6,128	14	%
General and administrative	1,739	13	% 1,796	11	% 4,904	13	% 5,686	13	%
Operating income	1,424	11	% 3,508	22	% 4,717	12	% 7,700	18	%
Other income (expense), net	100	1	% 54	0	% 194	1	% 244	1	%
Income before income taxes	1,524	12	% 3,562	22	% 4,911	13	% 7,944	18	%
Provision for income taxes	315	2	% 1,145	7	% 1,379	4	% 2,740	6	%
Net income	\$1,209	9	% \$2,417	15	% \$3,532	9	% \$5,204	12	%

Revenue

Revenue for the three months ended September 30, 2016 was approximately \$12.9 million, compared to \$15.9 million in the three months ended September 30, 2015, which included three quarters of licensing fees reflecting the execution of a licensing agreement in Q3 of 2015 even though the fees were due from the beginning of 2015 as per the terms of the agreement. This decrease of approximately 19% is partly due to lower licensing fees and mainly due to reduced demand for our products across most regions including North America.

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Revenue for the nine months ended September 30, 2016 was approximately \$37.9 million, a decrease of approximately 13% compared to the nine months ended September 30, 2015. The decrease in revenue was due to reduced demand for our products across most regions. The decrease was especially stronger in the Middle East, South Africa, Asia Pacific, Northern and Central Europe and Canada. The increase in revenues from video products was more than offset by a decline in revenues from all other product lines.

The net change in deferred revenue during the nine months ended September 30, 2016 from December 31, 2015 and the nine months ended September 30, 2015 from December 31, 2014 was a net decrease in deferred revenue of \$0.3 million and \$0.2 million, 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 decreased from 64% in the three months ended September 30, 2015 to 59% in the three months ended September 30, 2016. The reduction in gross profit margin for the three months ended September 30, 2016 was mainly due to a reduction of high margin products in the revenue mix and higher licensing fees in the three months ended September 30, 2015 when compared to the three months ended September 30, 2016. The gross profit margin also reduced due to higher inventory scrapping costs arising out of moving our manufacturing facility that we acquired along with Sabine to an overseas outsourced manufacturing facility.

Our GPM was 63% and 64% for the nine months ended September 30, 2016 and 2015, respectively. The decrease in GPM was primarily due to a reduction of high margin products in the revenue mix.

Our profitability in the near-term continues to depend significantly on our revenues from professional audio conferencing products, which includes wired and wireless microphones. We hold long-term inventory and if we are unable to sell our long-term inventory, our profitability might be affected by inventory write-offs and price mark-downs.

Operating Expenses

Operating expenses for the three months ended September 30, 2016 decreased by 7% to \$6.2 million from \$6.7 million for three months ended September 30, 2015. Operating expenses for the nine months ended September 30, 2016 decreased by approximately \$0.9 million to \$19.1 million compared to \$19.9 million for the nine months ended September 30, 2015.

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 \$2.4 million for the three months ended September 30, 2016 decreased by \$0.4 million when compared to S&M expenses of \$2.8 million for the three months ended September 30, 2015. The decrease was mainly due to reduction in commissions to independent agents and tradeshow costs.

S&M expenses of approximately \$7.7 million for the nine months ended September 30, 2016 decreased \$0.4 million, or 5%, when compared to S&M expenses of approximately \$8.1 million for the nine months ended September 30, 2015. The decreases in employee related costs, commissions to employees and independent agents and tradeshow costs were partially offset by marketing, tradeshow costs and consulting 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 \$2.1 million for the three months ended September 30, 2016 remained almost unchanged from \$2.1 million for the three months ended September 30, 2015.

R&D expenses of approximately \$6.5 million for the nine months ended September 30, 2016 increased by \$0.4 million, or 6%, when compared to R&D expenses of approximately \$6.1 million for the nine months ended September 30, 2015. R&D expenses increased mainly due to increases in costs for various R&D projects and employee 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.

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G&A expenses of approximately \$1.74 million for the three months ended September 30, 2016 remained almost unchanged from \$1.8 million for the three months ended September 30, 2015.

G&A expenses of approximately \$4.9 million for the nine months ended September 30, 2016 decreased by \$0.8 million, or 14%, when compared to G&A expenses of approximately \$5.7 million for the nine months ended September 30, 2015. G&A expenses decreased due to decreases in legal expenses, audit and accounting fees, and acquisition related amortization costs and other expenses, and due to elimination of compensation expense relating to dividend equivalents. These decreases were partially offset by an increase in recruitment costs and increase in allocation of overhead costs.

Other income (expense), net

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

Provision for income taxes

During the nine months ended September 30, 2016, we accrued income taxes at the forecasted effective tax rate of 32.3% as compared to the forecasted effective tax rate of 36.3% used during the nine months ended September 30, 2015. The 4.0% decrease in the forecasted effective tax rate was primarily due to the U.S. research and development tax credit, which was in effect for the nine months ended September 30, 2016, but had not been extended as of September 30, 2015. In addition, a discrete tax benefit of \$303 thousand is primarily attributable to a tax benefit related to stock-based compensation and changes in 2015 estimated R&D tax credits.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2016, our cash and cash equivalents were approximately \$12.2 million, a decrease of approximately \$1.2 million compared to cash and cash equivalents of approximately \$13.4 million as of December 31,

2015.

Net cash provided by operating activities was \$7.5 million during the nine months ended September 30, 2016, an increase in cash flow of approximately \$1.1 million compared to \$6.4 million of cash provided by operating activities during the nine months ended September 30, 2015. The increase in operating cash flow was primarily due to changes in operating assets and liabilities totaling \$3.6 million partially offset by reduction in non-cash charges by \$0.9 million and a decrease in net income of \$1.7 million.

Net cash used in investing activities was approximately \$1.8 million during the nine months ended September 30, 2016, an increase of \$0.8 million compared to \$1.0 million of cash used in investing activities during the nine months ended September 30, 2015. The increase in cash used in investing activities in nine months ended September 30, 2016 was due to an increase of about \$0.5 million in purchase of property and equipment and \$0.3 million in purchases of marketable securities net of proceeds from maturities and sales of marketable securities.

Net cash used in financing activities was approximately \$6.8 million during the nine months ended September 30, 2016 compared to \$0.3 million of cash used in financing activities during the nine months ended September 30, 2015. Financing activities during the nine months ended September 30, 2016 primarily consisted of cash outflows of \$5.1 million towards stock repurchases, \$1.8 million for the repurchase of stock options and \$1.4 million for dividend payments partially offset by cash inflows of about \$0.7 million from exercises of stock options and \$0.7 million from tax benefits from exercise of stock options. Financing activities during the nine months ended September 30, 2015 primarily consisted of cash outflows of \$0.6 million towards dividend payments partially offset by cash inflows of about \$0.3 million from proceeds from exercises of stock options and \$49 thousand from tax benefits from exercise of stock options.

As of September 30, 2016, our working capital was \$33.4 million as compared to \$36.5 million as of December 31, 2015.

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 sound business structure will enable us to raise additional capital if and 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 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 may also use cash to pay cash dividends or repurchase stock.

At September 30, 2016, we had open purchase orders related to our electronics manufacturing service providers of approximately \$5.2 million, primarily related to inventory purchases.

At September 30, 2016, we had inventory totaling \$15.2 million, of which non-current inventory accounted for \$1.7 million. This compares to total inventories of \$15.5 million and non-current inventory of \$2.0 million as of December 31, 2015.

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Off-Balance Sheet Arrangements

We have no off-balance-sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial conditions, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources, results of operations or liquidity.

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 our Annual Report on Form 10-K for the year ended December 31, 2015. We believe the following critical accounting policies 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 certain 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 distributor channel inventories. The following table details the amount of deferred revenue, cost of goods sold, and gross profit (in thousands) as of September 30, 2016 and December 31, 2015:

	September 30, 2016	December 31, 2015
Deferred revenue	\$ 4,271	\$ 4,549
Deferred cost of goods sold	1,538	1,628
Deferred gross profit	\$ 2,733	\$ 2,921

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.

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We offer credit terms on the sale of our products to a majority of our channel partners 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 channel partners 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 the Nine months ended September 30, 2016 or 2015 as no impairment indicators 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, 2015 and determined that based upon available evidence it is more likely than not that certain of our deferred tax assets related to foreign net operating loss carryforwards and foreign intangible assets will not be realized and, accordingly, we have recorded a valuation allowance against these deferred tax assets in the amount of \$1.1 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 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.

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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 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. The updated standard becomes effective for the Company on January 1, 2018. Early adoption is permitted. The Company has not yet selected a transition method and we are currently evaluating the effect that the updated standard will have on the consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740), simplifying the presentation of deferred taxes on the balance sheet by requiring companies to classify everything as either a non-current asset or non-current liability. Early adoption of this ASU is permitted. ClearOne has adopted this standard update early as it simplified the presentation of taxes on the balance sheet and within the income tax footnote.

In February 2016, FASB released Accounting Standards Update No. 2016-02, Leases (Topic 842) to bring transparency to lessee balance sheets. The ASU will require organizations that lease assets (lessees) to recognize assets and liabilities on the balance sheet for the rights and obligations created by all leases with terms of more than 12 months. The standard will apply to both types of leases-capital (or finance) leases and operating leases. Previously, GAAP has required only capital leases to be recognized on lessee balance sheets. The standard will take effect the Company for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early application will be permitted for all organizations. The Company has not yet selected a transition method and we are currently evaluating the effect that the updated standard will have on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation: Improvements to Employee Shared-Based Payment Accounting. The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. ASU 2016-09 is effective for the Company on January 1, 2017 and we are currently evaluating the impact that ASU 2016-09 will have on our consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Measurement of Credit Losses on Financial Instruments, which requires measurement and recognition of expected credit losses for financial assets held. ASU 2016-13 is effective for the Company beginning January 1, 2020 and we are currently evaluating the impact that ASU 2016-13 will have on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments, which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. ASU 2016-15 is effective for the Company beginning January 1, 2018 and we are currently evaluating the impact that ASU 2016-15 will have on our consolidated financial statements.

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CLEARONE, INC.

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

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 September 30, 2016 was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Principal Financial and Accounting Officer. Based on this evaluation, our management, including our Chief Executive Officer and Principal Financial and Accounting Officer, concluded that our disclosure controls and procedures are effective as of September 30, 2016 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 September 30, 2016 that materially affected, or that we believe is reasonably likely to materially affect, our internal control over financial reporting.

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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, 2015 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

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

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

In May 2012, our Board of Directors authorized a stock repurchase program authorizing the Company to repurchase up to \$2 million of our outstanding common stock. On July 30, 2012, the Board of Directors increased the repurchase amount to \$3 million from the original \$2 million. On February 20, 2013, the Board of Directors again increased the repurchase amount to \$10 million from \$3 million. On December 2, 2014, ClearOne, Inc. issued a press release announcing the declaration of future cash dividends by the Company's Board of Directors and reported the discontinuance of this stock repurchase program. At the time of the discontinuance of this stock repurchase program, the Company had repurchased approximately \$5.4 million of the Company's stock.

On March 9, 2016, the Board of Directors of the Company authorized the repurchase of up to \$10 million of the Company's outstanding shares of common stock under a new stock repurchase program. In connection with the repurchase authorization, the Company was authorized to complete the repurchase through open market transactions or through an accelerated share repurchase program, in each case to be executed at management's discretion based on business and market conditions, stock price, trading restrictions, acquisition activity and other factors. The repurchase program may be suspended or discontinued at any time without prior notice. The transactions effectuated to date occurred in open market purchases.

During the three months ended September 30, 2016 we acquired the following shares of common stock under the current stock repurchase program:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 to July 31	39,441	\$ 11.30	39,441	\$ 5,430,603
August 1 to August 31	16,700	10.90	16,700	5,248,491
September 1 to September 30	35,824	11.13	35,824	4,849,675
Total	91,965	11.16	91,965	4,849,675

From March 11, 2016 to March 17, 2016, the Company offered to repurchase eligible vested options to purchase shares under the 1998 Plan and the 2007 Plan from employees. The Company repurchased delivered options at a repurchase price equal to the difference between the closing market price on the date of the employee's communication of accepting the repurchase offer and the exercise price of such employee's delivered options, subject to applicable withholding taxes and charges. The Company repurchased 225,542 stock options from employees at an average purchase price of \$7.77

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

Not applicable.

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CLEARONE, INC.

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)

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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)

By: */s/ Zeynep Hakimoglu*
Zeynep Hakimoglu

November 8, 2016 Chief Executive Officer

(Principal Executive Officer)

By: */s/ Narsi Narayanan*
Narsi Narayanan

November 8, 2016 Senior Vice President of Finance

(Principal Financial and Accounting Officer)

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"1"> 5.2 9.6 6.1 1.3 5.7 .3 1.6 76.4 91.4

Undeveloped lease amortization

19.9 7.1 4.1 31.1

Total exploration expenses

26.0 8.4 5.7 .3 1.6 80.5 122.5

Selling and general expenses

11.0 3.3 .2 (1.3) .9 .7 10.3 25.1

Results of operations before taxes

79.6 74.0 59.7 272.1 18.9 .6 (68.2) 436.7

Income tax provisions

27.5 21.9 16.0 106.1 9.6 3.9 8.4 193.4

Results of operations (excluding corporate overhead and interest)

\$52.1 52.1 43.7 166.0 9.3 (3.3) (76.6) 243.3

Three Months Ended June 30, 2010

Oil and gas sales and other operating revenues

\$167.6 140.9 100.0 429.4 29.1 25.4 .3 892.7

Production expenses

33.7 26.5 47.7 70.3 5.0 14.6 197.8

Depreciation, depletion and amortization

80.1 47.0 12.2 90.9 5.8 12.7 .3 249.0

Accretion of asset retirement obligations

1.7 1.2 1.6 2.4 .6 .0 .1 7.6

Exploration expenses

Dry holes

7.9 .1 (.5) 7.5

Geological and geophysical

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4.7 (.1) .8 .1 3.1 1.3 9.9

Other

3.1 .1 .1 (.3) 5.2 8.2 7.8 8.7 .2 2.9 6.0 25.6

Undeveloped lease amortization

18.3 8.0 1.3 27.6

Total exploration expenses

26.1 8.0 8.7 .2 2.9 7.3 53.2

Terra Nova working interest redetermination

5.4 5.4

Selling and general expenses

5.4 2.9 .2 .2 .7 .3 8.0 17.7

Results of operations before taxes

20.6 49.9 38.3 256.9 16.8 (5.1) (15.4) 362.0

Income tax provisions

6.1 15.0 10.9 98.7 8.4 3.8 142.9

Results of operations (excluding corporate overhead and interest)

\$14.5 34.9 27.4 158.2 8.4 (8.9) (15.4) 219.1

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)****Results of Operations (Contd.)****OIL AND GAS OPERATING RESULTS SIX MONTHS ENDED JUNE 30, 2011 AND 2010**

(Millions of dollars)	United States	Canada		Malaysia	United Kingdom	Republic of the Congo	Other	Total
		Conventional	Synthetic					
Six Months Ended June 30, 2011								
Oil and gas sales and other operating revenues	\$ 366.5	355.2	259.8	957.3	63.7	67.7	24.4	2,094.6
Production expenses	77.5	68.3	116.8	187.8	14.5	16.8		481.7
Depreciation, depletion and amortization	91.3	124.2	26.6	171.7	8.3	37.8	.8	460.7
Accretion of asset retirement obligations	4.9	2.5	3.9	5.3	1.6	.3	.2	18.7
Exploration expenses								
Dry holes	.6					2.9	101.8	105.3
Geological and geophysical	20.6	2.5		5.8	.3	1.6	2.5	33.3
Other	7.3	.6			.2	.1	11.5	19.7
	28.5	3.1		5.8	.5	4.6	115.8	158.3
Undeveloped lease amortization	38.3	14.0					8.2	60.5
Total exploration expenses	66.8	17.1		5.8	.5	4.6	124.0	218.8
Terra Nova working interest redetermination		(5.4)						(5.4)
Selling and general expenses	20.4	6.6	.4		1.7	.3	18.1	47.5
Results of operations before taxes	105.6	141.9	112.1	586.7	37.1	7.9	(118.7)	872.6
Income tax provisions	37.0	41.7	30.1	224.9	18.8	7.6	8.8	368.9
Results of operations (excluding corporate overhead and interest)	\$ 68.6	100.2	82.0	361.8	18.3	.3	(127.5)	503.7
Six Months Ended June 30, 2010								
Oil and gas sales and other operating revenues	\$ 342.6	276.1	187.7	933.3	81.5	53.7	2.6	1,877.5
Production expenses	66.5	52.3	99.5	154.1	14.2	26.5		413.1
Depreciation, depletion and amortization	155.5	93.1	22.2	196.8	14.1	22.1	.6	504.4
Accretion of asset retirement obligations	3.4	2.4	3.2	4.7	1.1	.1	.2	15.1
Exploration expenses								
Dry holes	.1			30.5		(.3)	(.5)	29.8
Geological and geophysical	17.1	.5		1.0	.5	3.4	3.4	25.9
Other	5.7	.2		.0	.2		9.3	15.4
	22.9	.7		31.5	.7	3.1	12.2	71.1
Undeveloped lease amortization	31.2	14.7					2.5	48.4

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Total exploration expenses	54.1	15.4		31.5	.7	3.1	14.7	119.5
Terra Nova working interest redetermination		10.9						10.9
Selling and general expenses	13.4	6.5	.4	.3	1.6	(.6)	15.2	36.8
Results of operations before taxes	49.7	95.5	62.4	545.9	49.8	2.5	(28.1)	777.7
Income tax provisions	16.5	28.6	17.8	214.2	24.8	8.9	.8	311.6
Results of operations (excluding corporate overhead and interest)	\$ 33.2	66.9	44.6	331.7	25.0	(6.4)	(28.9)	466.1

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)****Results of Operations (Contd.)**Refining and Marketing*Second Quarter 2011 vs 2010*

In 2010, the Company announced its intention to sell its three refineries and U.K. marketing operations during 2011. The Company entered into an agreement to sell the Superior, Wisconsin refinery and associated assets on July 25, 2011. The sale is expected to be completed late in the third quarter or early in the fourth quarter. The sale process for the Meraux, Louisiana refinery and U.K. downstream operations continues to progress. See Note B in the consolidated financial statements for further discussion.

United States Manufacturing operations include two refineries and two ethanol production facilities. United States Marketing includes retail and wholesale fuel marketing operations. Transactions between these two U.S. downstream segments are recorded at agreed market-based transfer prices and eliminations have been made as necessary within the consolidated financial statements. The United Kingdom refining and marketing segment includes the Milford Haven, Wales, refinery and U.K. retail and other refined products marketing operations.

Results of refining and marketing operations are presented below by segment.

	Income (Loss)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
(Millions of dollars)				
Refining and marketing				
United States manufacturing	\$ 27.3	9.8	56.0	(13.8)
United States marketing	80.2	69.6	90.9	78.5
United Kingdom	(15.8)	4.4	(24.5)	(10.6)
Total	\$ 91.7	83.8	122.4	54.1

United States manufacturing operations generated a profit of \$27.3 million in the 2011 second quarter compared to a profit of \$9.8 million during the second quarter of 2010. The favorable result in 2011 was primarily due to stronger U.S. refining margins, which improved from \$0.69 per barrel in the second quarter of 2010 to \$2.54 per barrel in the 2011 quarter. Additionally, crude oil feedstock throughput volumes at U.S. refineries were a quarterly record of 170,475 barrels per day during the 2011 quarter. Ethanol production operations were less profitable in 2011 than 2010, primarily due to below break-even results during the operational start-up phase at the Hereford, Texas plant in the second quarter. The ramp-up of production at the Hereford plant has met Company expectations.

United States marketing operations generated income of \$80.2 million in the second quarter 2011 compared to income of \$69.6 million in the 2010 period. The favorable result in the 2011 quarter was primarily due to an improvement in U.S. retail marketing margins, which totaled \$0.199 per gallon in 2011 and \$0.162 per gallon in 2010. In addition, these U.S. retail operations generated higher profits from merchandise sales in the 2011 quarter. However, overall per-store retail fuel sales volumes in the current period were below 2010 levels by about 10%.

Refining and marketing operations in the United Kingdom had a loss of \$15.8 million in the second quarter of 2011 compared to a profit of \$4.4 million in the same quarter of 2010. The U.K. results in 2011 were unfavorably affected by weaker margins during the 2011 quarter. The 2010 period included a \$6.0 million benefit from an adjustment of income taxes. Crude oil throughput volumes at the Milford Haven refinery were a quarterly record of 136,428 barrels per day during the 2011 quarter, but throughputs in the 2010 quarter were at significantly lower levels as the plant was shut down for turnaround for a portion of the quarter. The plant came back onstream in May 2010, but experienced inefficient operations upon restart. A capital project completed during the 2010 turnaround expanded the crude oil throughput capacity of the refinery from

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108,000 to 135,000 barrels per day.

Worldwide petroleum product sales were 601,498 barrels per day in the 2011 quarter, up from 508,117 barrels per day a year ago. This increase was mostly due to the aforementioned refinery turnaround at Milford Haven during the prior-year second quarter.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Results of Operations (Contd.)

Refining and Marketing (Contd.)

Six months 2011 vs. 2010

United States manufacturing operations generated a profit of \$56.0 million in the first six months of 2011 compared to a loss of \$13.8 million during the 2010 period. The favorable result in 2011 was primarily due to stronger U.S. refining margins, which improved to \$2.73 per barrel in 2011 compared to a negative \$1.23 per barrel in 2010. Additionally, crude oil throughput volumes at U.S. refineries were 167,753 barrels per day during the 2011 period compared to 125,897 barrels per day in 2010. Lower throughput volumes in 2010 were primarily due to the effects of a six-week complete plant turnaround at the Meraux, Louisiana, refinery during the prior year. Ethanol production operations generated near break-even results in the first six months of 2011, which was below 2010 profit levels. The reduction in 2011 was primarily attributable to unprofitable operations during start-up of the Hereford, Texas, plant during the 2011 second quarter.

United States marketing operations generated income of \$90.9 million in the six-month 2011 period, compared to income of \$78.5 million in the 2010 period. The favorable result in 2011 was primarily due to U.S. retail marketing margins which improved to \$0.146 per gallon in 2011 following a margin of \$0.123 per gallon in 2010. In addition, these U.S. retail operations generated higher profits from merchandise sales in 2011. However, overall per-store fuel sales volumes for the retail operations in the 2011 period were below 2010 levels by about 9%.

Refining and marketing operations in the United Kingdom had a loss of \$24.5 million in the 2011 six months compared to a loss of \$10.6 million in the same 2010 period. The U.K. results in 2011 were hurt by continued weak refining margins. Higher crude oil throughputs at the Milford Haven, Wales, refinery led to larger volumes of products sold into the weak pricing market, generating a larger overall loss in the current year. Crude oil throughput volumes at Milford Haven were 128,919 barrels per day in 2011, up from 53,029 barrels per day in 2010, as the plant was shut down for turnaround for several months in 2010.

Total petroleum product sales were 583,019 barrels per day in the 2011 period, up from 493,486 barrels per day a year ago. This increase was also mostly due to the aforementioned refinery turnarounds at Meraux and Milford Haven during the prior year.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)****Results of Operations (Contd.)**

Selected operating statistics for the three-month and six-month periods ended June 30, 2010 and 2009 follow.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Refinery inputs barrels per day	314,388	207,186	304,342	188,497
United States	174,502	158,635	171,874	130,883
Crude oil Meraux, Louisiana	135,528	119,187	132,864	93,127
Superior, Wisconsin	34,947	33,662	34,889	32,770
Other feedstocks	4,027	5,786	4,121	4,986
United Kingdom	139,886	48,551	132,468	57,614
Crude oil Milford Haven, Wales	136,428	45,104	128,919	53,029
Other feedstocks	3,458	3,447	3,549	4,585
Refinery yields barrels per day	314,388	207,186	304,342	188,497
United States	174,502	158,635	171,874	130,883
Gasoline	70,174	66,087	70,403	54,944
Kerosine	15,098	13,484	15,289	10,493
Diesel and home heating oils	53,994	43,499	50,462	34,441
Residuals	17,176	22,180	16,091	18,072
Asphalt	16,320	12,955	18,645	12,150
Fuel and loss	1,740	430	984	783
United Kingdom	139,886	48,551	132,468	57,614
Gasoline	36,843	8,390	31,742	13,308
Kerosine	17,937	6,843	17,043	8,323
Diesel and home heating oils	49,499	13,577	46,180	15,915
Residuals	14,951	3,958	13,259	5,560
Asphalt	17,359	13,263	21,251	12,006
Fuel and loss	3,297	2,520	2,993	2,502
Petroleum products sold barrels per day	601,498	508,117	583,019	493,486
Total United States	459,209	459,277	448,551	435,110
United States Manufacturing	177,878	163,113	169,851	131,673
Gasoline	81,999	73,741	80,223	62,319
Kerosine	15,098	13,484	15,289	10,493
Diesel and home heating oils	53,030	43,499	50,063	34,441
Residuals	16,926	22,523	16,080	17,965
Asphalt, LPG and other	10,825	9,866	8,196	6,455
United States Marketing	431,350	426,888	424,135	410,689
Gasoline	330,976	333,781	325,485	325,232
Kerosine	13,768	11,766	14,886	9,487
Diesel and other	86,606	81,341	83,764	75,970
United States Intercompany Elimination	(150,019)	(130,724)	(145,435)	(107,252)
Gasoline	(81,999)	(73,743)	(80,223)	(62,319)
Kerosine	(15,098)	(13,482)	(15,289)	(10,492)
Diesel and other	(52,922)	(43,499)	(49,923)	(34,441)
United Kingdom	142,289	48,840	134,468	58,376
Gasoline	39,943	15,535	33,349	16,235

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Kerosine	16,664	6,763	16,115	8,314
Diesel and home heating oils	49,859	19,034	47,305	20,358
Residuals	17,526	2,142	14,543	5,192
LPG and other	18,297	5,366	23,156	8,277
Unit margins per barrel:				
United States refining ¹	\$ 2.54	\$ 0.69	\$ 2.73	\$ (1.23)
United Kingdom refining and marketing	\$ (1.76)	0.52	\$ (1.22)	(1.65)
United States retail marketing:				
Fuel margin per gallon ²	\$ 0.199	\$ 0.162	\$ 0.146	\$ 0.123
Gallons sold per store month	283,111	316,378	277,658	304,294
Merchandise sales revenue per store month	\$ 161,722	\$ 158,586	\$ 155,072	\$ 148,576
Merchandise margin as a percentage of merchandise sales	12.9%	12.9%	13.3%	12.6%
Store count at end of period (Company operated)	1,118	1,067	1,118	1,067

¹ Represents refinery sales realizations less cost of crude and other feedstocks and refinery operating and depreciation expenses.

² Represents net sales prices for fuel less purchased cost of fuel.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)****Results of Operations (Contd.)**Corporate

Corporate activities, which include interest income and expense, foreign exchange effects, and corporate overhead not allocated to operating functions, had net costs of \$23.4 million in the 2011 second quarter compared to net costs of \$30.6 million in the second quarter of 2010. The 2011 results of corporate activities were favorable to 2010 primarily due to net after-tax gains of \$4.9 million on transactions denominated in foreign currencies in the current quarter compared to net after-tax losses of \$1.6 million in the comparable 2010 period.

For the first six months of 2011, corporate activities reflected net costs of \$45.6 million compared to net costs of \$99.0 million a year ago. Six-month corporate costs in 2011 were significantly favorable to 2010 mostly related to the effects of transactions denominated in foreign currencies. Total after-tax gains for foreign currency transactions were \$3.9 million in the 2011 period compared to net costs of \$42.9 million after taxes in the first six months of 2010. Net interest expense was less in 2011 compared to 2010 due to lower average interest rates on outstanding debt and higher interest capitalized to oil and gas development projects. Administrative expense was higher in 2011 associated with increased employee compensation costs.

Financial Condition

Net cash provided by operating activities was \$917.9 million for the first six months of 2011 compared to \$1,447.7 million during the same period in 2010. Changes in operating working capital other than cash and cash equivalents used cash of \$455.7 million in the first six months of 2011, but provided cash of \$249.8 million in the first six months of 2010. Cash was used for working capital in 2011 due to an increase in accounts receivable caused by higher sales prices and an increase in crude oil inventories caused by higher volumes held, which were only partially offset by an increase in accounts payable balances. Cash generated from working capital changes in the 2010 period included a \$244.4 million recovery of U.S. federal royalties paid in prior years on oil and natural gas production in the Gulf of Mexico. Cash of \$754.1 million in the 2011 period and \$1,239.3 million in 2010 was generated from maturity of Canadian government securities that had maturity dates greater than 90 days at acquisition. The sale of gas storage assets in Spain in June 2011 generated cash proceeds of \$27.4 million.

Significant uses of cash in both years were for dividends, which totaled \$106.3 million in 2011 and \$95.7 million in 2010, and for property additions and dry holes, which including amounts expensed, were \$1,258.7 million and \$992.3 million in the six-month periods ended June 30, 2011 and 2010, respectively. Also, the purchase of Canadian government securities with maturity dates greater than 90 days at acquisition used cash of \$675.6 million in the 2011 period and \$1,263.0 million in the 2010 period. Total accrual basis capital expenditures for continuing operations were as follows:

(Millions of dollars)	Six Months Ended June 30,	
	2011	2010
Capital Expenditures		
Exploration and production	\$ 1,256.9	906.8
Refining and marketing	88.3	189.5
Corporate and other	3.5	3.1
Total capital expenditures	1,348.7	1,099.4

A reconciliation of property additions and dry hole costs in the consolidated statements of cash flows to total capital expenditures follows.

Six Months Ended June 30,

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(Millions of dollars)	2011	2010
Property additions and dry hole costs per cash flow statements	\$ 1,258.7	992.3
Geophysical and other exploration expenses	53.0	41.3
Capital expenditure accrual changes	37.0	65.8
Total capital expenditures	1,348.7	1,099.4

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)****Financial Condition (Contd.)**

Working capital (total current assets less total current liabilities) at June 30, 2011 was \$870.4 million, an increase of \$250.7 million from December 31, 2010. This level of working capital does not fully reflect the Company's liquidity position because the lower historical costs assigned to inventories under last-in first-out accounting were \$974.3 million below fair value at June 30, 2011. During the second quarter 2011, the Company's \$350 million notes maturing in May 2012 were reclassified to a current liability.

At June 30, 2011, long-term notes payable of \$1,184.5 million had increased by \$245.1 million compared to December 31, 2010. A summary of capital employed at June 30, 2011 and December 31, 2010 follows.

(Millions of dollars)	June 30, 2011		Dec. 31, 2010	
	Amount	%	Amount	%
Capital employed				
Long-term debt	\$ 1,184.5	11.8	939.4	10.3
Stockholders' equity	8,829.2	88.2	8,199.5	89.7
Total capital employed	\$ 10,013.7	100.0	9,138.9	100.0

The Company's ratio of earnings to fixed charges was 26.9 to 1 for the six-month period ended June 30, 2011.

Accounting and Other Matters

The Company adopted new guidance issued by the Financial Accounting Standards Board (FASB) regarding accounting for transfers of financial assets effective January 1, 2010. This guidance makes the concept of a qualifying special-purpose entity as defined previously no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities must be reevaluated for consolidation by reporting entities in accordance with the applicable consolidation guidance. This adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

The Company adopted, effective January 1, 2010, new guidance issued by the FASB that requires a company to perform an analysis to determine whether its variable interests give it a controlling financial interest in a variable interest entity. The primary beneficiary of a variable interest entity has both the power to direct the activities of the entity that most significantly impact the entity's economic performance and the obligation to absorb potentially significant losses of the entity or the right to receive potentially significant benefits from the entity. A company is required to make ongoing reassessments of whether it is the primary beneficiary of a variable interest entity. This guidance also amended previous guidance for determining whether an entity is considered a variable interest entity. The adoption of this guidance did not have a significant effect on the Company's consolidated financial statements.

In July 2010, the FASB issued new accounting guidance that expanded the disclosure requirements about financing receivables and the related allowance for credit losses. This guidance became effective for the Company at December 31, 2010. Because the Company has no significant financing receivables that extend beyond one year, the impact of this guidance did not have a significant effect on its consolidated financial statement disclosures.

The United States Congress passed the Dodd-Frank Act in 2010. Among other requirements, the law requires companies in the oil and gas industry to disclose payments made to the U.S. Federal and all foreign governments. The SEC was directed to develop the reporting requirements in accordance with the law. The SEC has issued preliminary guidance and has sought feedback thereon from all interested parties. The preliminary rules indicated that payment disclosures would be required at a project level within the annual Form 10-K report beginning with the year ending December 31, 2012. The Company cannot predict the final disclosure requirements that will be required by the Dodd-Frank Act.

Outlook

Average crude oil prices in July 2011 were somewhat lower than the average price during the second quarter of 2011. The Company expects its oil and natural gas production to average about 173,000 barrels of oil equivalent per day in the third quarter 2011. U.S. retail marketing margins have fallen significantly in July versus the average margins achieved in the second quarter 2011, while U.S. refining margins have strengthened during July. U.K. downstream margins remain extremely weak early in the third quarter 2011. The Company currently anticipates total capital expenditures for the full year 2011 to be approximately \$3.3 billion.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Forward-Looking Statements

This Form 10-Q contains forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements, which express management's current views concerning future events or results, are subject to inherent risks and uncertainties. Factors that could cause actual results to differ materially from those expressed or implied in our forward-looking statements include, but are not limited to, the volatility and level of crude oil and natural gas prices, the level and success rate of our exploration programs, our ability to maintain production rates and replace reserves, customer demand for our products, political and regulatory instability, and uncontrollable natural hazards. For further discussion of risk factors, see Murphy's 2010 Annual Report on Form 10-K on file with the U.S. Securities and Exchange Commission. Murphy undertakes no duty to publicly update or revise any forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks associated with interest rates, prices of crude oil, natural gas and petroleum products, and foreign currency exchange rates. As described in Note J to this Form 10-Q report, Murphy periodically makes use of derivative financial and commodity instruments to manage risks associated with existing or anticipated transactions. There were short-term commodity derivative contracts in place at June 30, 2011 to hedge the purchase price of about 0.2 million barrels of crude oil and other feedstocks at the Company's refineries. Additionally, there were short-term commodity derivative contracts in place at June 30, 2011 to hedge the purchase price of 10.8 million bushels of corn and to hedge the inventory value of 2.6 million bushels of corn. A 10% increase in the respective benchmark price of these commodities would have reduced the recorded asset associated with these derivative contracts by approximately \$5.3 million, while a 10% decrease would have increased the recorded asset by a similar amount. Changes in the fair value of these derivative contracts generally offset the changes in the value for an equivalent volume of these feedstocks.

There were short-term derivative foreign exchange contracts in place at June 30, 2011 to hedge the value of the U.S. dollar against two foreign currencies. A 10% strengthening of the U.S. dollar against these foreign currencies would have reduced the recorded net asset associated with these contracts by approximately \$34.0 million, while a 10% weakening of the U.S. dollar would have increased the recorded net asset by approximately \$27.8 million. Changes in the fair value of these derivative contracts generally offset the financial statement impact of an equivalent volume of foreign currency exposures associated with other assets and/or liabilities.

ITEM 4. CONTROLS AND PROCEDURES

Under the direction of its principal executive officer and principal financial officer, controls and procedures have been established by the Company to ensure that material information relating to the Company and its consolidated subsidiaries is made known to the officers who certify the Company's financial reports and to other members of senior management and the Board of Directors.

Based on the Company's evaluation as of the end of the period covered by the filing of this Quarterly Report on Form 10-Q, the principal executive officer and principal financial officer of Murphy Oil Corporation have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by Murphy Oil Corporation in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

There have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Litigation arising out of a June 10, 2003 fire in the Residual Oil Supercritical Extraction (ROSE) unit at the Company's Meraux, Louisiana refinery was settled in July 2009 and memorialized via a filing in the U.S. District Court for the Eastern District of Louisiana on July 24, 2009. An arbitral tribunal heard the Company's claim for indemnity from one of its insurers, AEGIS, in September 2009 and the tribunal ruled in favor of the Company. The Company continues to believe that the ultimate resolution of the June 2003 ROSE fire matter will not have a material adverse effect on its net income, financial condition or liquidity in a future period.

Murphy is engaged in a number of other legal proceedings, all of which Murphy considers routine and incidental to its business. Based on information currently available to the Company, the ultimate resolution of environmental and legal matters referred to in this note is not expected to have a material adverse effect on the Company's net income, financial condition or liquidity in a future period.

ITEM 1A. RISK FACTORS

The Company's operations in the oil and gas business naturally lead to various risks and uncertainties. These risk factors are discussed in Item 1A. Risk Factors in our 2010 Form 10-K filed on February 28, 2011. The Company has not identified any additional risk factors not previously disclosed in its 2010 Form 10-K report.

ITEM 6. EXHIBITS

The Exhibit Index on page 33 of this Form 10-Q report lists the exhibits that are hereby filed, incorporated by reference, or furnished with this report.

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SIGNATURE

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

MURPHY OIL CORPORATION

(Registrant)

By /s/ JOHN W. ECKART

John W. Eckart, Vice President and Controller

(Chief Accounting Officer and Duly Authorized Officer)

August 5, 2011

(Date)

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EXHIBIT INDEX

Exhibit	
No.	
12.1*	Computation of Ratio of Earnings to Fixed Charges
31.1*	Certification required by Rule 13a-14(a) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification required by Rule 13a-14(a) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101. INS	XBRL Instance Document
101. SCH	XBRL Taxonomy Extension Schema Document
101. CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101. DEF	XBRL Taxonomy Extension Definition Linkbase Document
101. LAB	XBRL Taxonomy Extension Labels Linkbase Document
101. PRE	XBRL Taxonomy Extension Presentation Linkbase

* This exhibit is incorporated by reference within this Form 10-Q. Attached as Exhibit 101 to this report are documents formatted in XBRL (Extensible Business Reporting Language). Users of this data are advised pursuant to Rule 406T of Regulation S-T that the interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of section 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise not subject to liability under these sections. The financial information contained in the XBRL-related documents is unaudited or unreviewed.

Exhibits other than those listed above have been omitted since they are either not required or not applicable.