

AWARE INC /MA/
Form 10-Q
August 02, 2012

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

FORM 10-Q

Quarterly Report Pursuant To Section 13 Or 15(d) Of The
Securities Exchange Act of 1934

For the quarter ended June 30, 2012

Commission file number 000-21129

AWARE, INC.
(Exact Name of Registrant as Specified in Its Charter)

Massachusetts	04-2911026
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

40 Middlesex Turnpike, Bedford, Massachusetts, 01730
(Address of Principal Executive Offices)
(Zip Code)

(781) 276-4000
(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

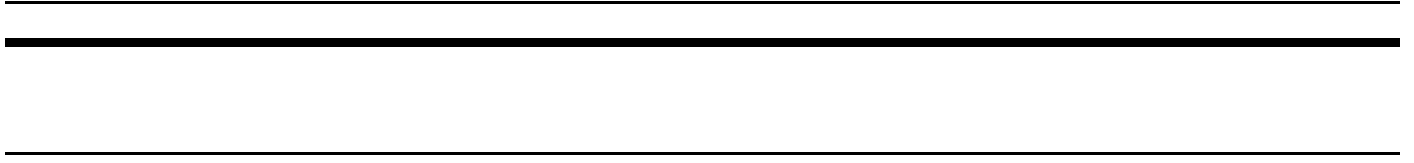
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large Accelerated Filer Accelerated Filer Non-Accelerated Filer 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

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Indicate the number of shares outstanding of the issuer's common stock as of July 25, 2012:

Class	Number of Shares Outstanding
Common Stock, par value \$0.01 per share	22,328,737 shares



AWARE, INC.

FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2012

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PART 1. FINANCIAL INFORMATION
ITEM 1: CONSOLIDATED FINANCIAL STATEMENTS
AWARE, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	June 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$101,058	\$46,577
Accounts receivable, net	4,317	3,546
Inventories	265	547
Prepaid expenses and other current assets	238	213
Total current assets	105,878	50,883
Property and equipment, net	6,064	6,232
Investments	-	727
Other assets, net	1	9
Total assets	\$111,943	\$57,851
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$543	\$399
Accrued expenses	114	121
Accrued compensation	1,049	868
Accrued professional	226	109
Accrued income taxes	4,083	-
Deferred revenue	1,715	1,317
Total current liabilities	7,730	2,814
Long-term deferred revenue	358	462
Stockholders' equity:		
Preferred stock, \$1.00 par value; 1,000,000 shares authorized, none outstanding	-	-
Common stock, \$.01 par value; 70,000,000 shares authorized; issued and outstanding 22,260,377 as of June 30, 2012 and 20,622,889 as of December 31, 2011	223	206
Additional paid-in capital	98,218	79,512
Accumulated other comprehensive loss	-	(20)
Retained earnings (accumulated deficit)	5,414	(25,123)
Total stockholders' equity	103,855	54,575
Total liabilities and stockholders' equity	\$111,943	\$57,851

The accompanying notes are an integral part of the consolidated financial statements.

AWARE, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Revenue:				
Product sales	\$4,027	\$ 3,997	\$8,578	\$9,075
Services	683	1,375	1,375	2,204
Royalties	624	541	1,115	993
Total revenue	5,334	5,913	11,068	12,272
Costs and expenses:				
Cost of product sales	830	1,087	1,290	2,308
Cost of services	361	450	717	807
Research and development	1,653	1,810	3,406	3,770
Selling and marketing	1,046	1,060	2,184	2,111
General and administrative	1,075	1,789	2,060	2,986
Total costs and expenses	4,965	6,196	9,657	11,982
Income (loss) from operations	369	(283)	1,411	290
Gain on sale of patent assets	71,226	-	71,226	-
Other income	59	-	85	-
Interest income	40	16	92	35
Income (loss) before provision for income taxes	71,694	(267)	72,814	325
Provision for income taxes	16,768	-	16,770	2
Net income (loss)	\$54,926	(\$267)	\$56,044	\$323
Other comprehensive income, net of \$0 tax:				
Unrealized gains (loss) on available for sale securities	(39)	-	20	-
Comprehensive income (loss)	\$54,887	(\$267)	\$56,064	\$323
Net income (loss) per share – basic	\$2.52	(\$0.01)	\$2.64	\$0.02
Net income (loss) per share – diluted	\$2.49	(\$0.01)	\$2.60	\$0.02
Weighted average shares – basic	21,757	20,700	21,241	20,461
Weighted average shares - diluted	22,099	20,700	21,583	20,821

The accompanying notes are an integral part of the consolidated financial statements.

AWARE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$56,044	\$323
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	235	244
Stock-based compensation	278	885
Gain on sale of patent assets	(71,226)	-
Excess tax benefits from stock-based compensation	12,684	-
Amortization of discount on investments	(24)	-
Gain on sale of investments	(85)	-
Provision for doubtful accounts	4	-
Changes in assets and liabilities:		
Accounts receivable	(775)	(105)
Inventories	282	450
Prepaid expenses and other current assets	(25)	(5)
Accounts payable	144	86
Accrued expenses, compensation, and professional	291	(443)
Accrued income taxes	4,083	-
Deferred revenue	294	406
Net cash provided by operating activities	2,204	1,841
Cash flows from investing activities:		
Purchases of property and equipment	(59)	(88)
Sales of investments	855	-
Proceeds from sale of patent assets, net	71,226	-
Net cash provided by (used in) investing activities	72,022	(88)
Cash flows from financing activities:		
Proceeds from issuance of common stock	5,798	1,684
Payment of dividends	(25,506)	-
Shares surrendered by employees to pay taxes related to unrestricted stock	(37)	(154)
Net cash provided by (used in) financing activities	(19,745)	1,530
Increase in cash and cash equivalents	54,481	3,283
Cash and cash equivalents, beginning of period	46,577	39,949
Cash and cash equivalents, end of period	\$101,058	\$43,232

The accompanying notes are an integral part of the consolidated financial statements.

AWARE, INC.
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (unaudited)

A) Basis of Presentation. The accompanying unaudited consolidated balance sheet, statements of comprehensive income, and statements of cash flows reflect all adjustments (consisting only of normal recurring items) which are, in the opinion of management, necessary for a fair presentation of financial position at June 30, 2012, and of operations and cash flows for the interim periods ended June 30, 2012 and 2011.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and therefore do not include all information and notes necessary for a complete presentation of our financial position, results of operations and cash flows, in conformity with generally accepted accounting principles. We filed audited financial statements which included all information and notes necessary for such presentation for the three years ended December 31, 2011 in conjunction with our 2011 Annual Report on Form 10-K. This Form 10-Q should be read in conjunction with that Form 10-K.

The results of operations for the interim period ended June 30, 2012 are not necessarily indicative of the results to be expected for the year.

B) Fair Value Measurements. The Financial Accounting Standards Board (“FASB”) issued authoritative guidance for fair value measurements, which defines fair value, establishes a framework for measuring fair value, and expands disclosures for assets and liabilities measured at fair value in financial statements. The fair value guidance establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Our cash and cash equivalents, which primarily include money market funds, were \$101.1 million and \$46.6 million as of June 30, 2012 and December 31, 2011, respectively. We classified our cash and cash equivalents within Level 1 of the fair value hierarchy because they are valued using quoted market prices.

Our investments, which consist of high yield corporate debt securities, are also classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. We categorize our investments as available-for-sale securities, and carry them at fair value in our financial statements. We had \$0.7 million of available-for-sale investments as of December 31, 2011.

C) Inventories. Inventories are stated at the lower of cost or net realizable value with cost being determined by the first-in, first-out (“FIFO”) method. Inventory reserves are established for estimated excess and obsolete inventory. Inventories consist primarily of the following (in thousands):

	June 30, 2012	December 31, 2011
Raw materials	\$ 127	\$ 339
Finished goods	138	208
Total	\$ 265	\$ 547

D)

Computation of Earnings per Share. Basic earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing net income or loss by the weighted average number of common shares outstanding plus additional common shares that would have been outstanding if dilutive potential common shares had been issued. For the purposes of this calculation, stock options are considered common stock equivalents in periods in which they have a dilutive effect. Stock options that are anti-dilutive are excluded from the calculation.

Net income per share is calculated as follows (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Net income (loss)	\$54,926	(\$267)	\$56,044	\$323
Weighted-average common shares outstanding	21,757	20,700	21,241	20,461
Additional dilutive common stock equivalents	342	-	342	360
Diluted shares outstanding	22,099	20,700	21,583	20,821
Net income (loss) per share – basic	\$2.52	(\$0.01)	\$2.64	\$0.02
Net income (loss) per share – diluted	\$2.49	(\$0.01)	\$2.60	\$0.02

For the three month period ended June 30, 2011 potential common stock equivalents of 286,803 were not included in the per share calculation for diluted EPS, because we had a net loss and the effect of their inclusion would be anti-dilutive.

For the three month periods ended June 30, 2012 and 2011, options to purchase 826,004 and 2,927,451 shares of common stock, respectively, were outstanding, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common stock and thus would be anti-dilutive. For the six month periods ended June 30, 2012 and 2011, options to purchase 1,034,754 and 2,322,772 shares of common stock, respectively, were outstanding, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common stock and thus would be anti-dilutive.

E) Stock-Based Compensation. The following table presents stock-based employee compensation expenses included in our unaudited consolidated statements of comprehensive income (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Cost of product sales	\$1	\$2	\$1	\$4
Cost of services	6	10	12	19
Research and development	36	64	73	131
Selling and marketing	57	22	135	44
General and administrative	31	484	57	687
Stock-based compensation expense	\$131	\$582	\$278	\$885

Stock Option and SAR Grants. We grant stock options and stock appreciation rights (“SARs”) under our 2001 Nonqualified Stock Plan. We estimate the fair value of stock options and SARs using the Black-Scholes valuation model. This valuation model takes into account the exercise price of the award, as well as a variety of significant assumptions. The assumptions used to estimate the fair value of stock options and SARs include the expected term, the expected volatility of our stock over the expected term, the risk-free interest rate over the expected term, and our expected annual dividend yield. We believe that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of our stock options and SARs. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity

awards.

Unrestricted Stock Grants. We also grant unrestricted shares of stock to directors, officers and employees under our 2001 Nonqualified Stock Plan. Stock-based compensation expense for stock grants is determined based on the fair market value of our stock on the date of grant; provided the number of shares in the grant is fixed on the grant date.

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Stock Option, SAR, and Unrestricted Stock Grant Activity. The following summarizes stock-based grant activity in 2012 and 2011.

Stock options and SARS – We granted stock options for 25,000 and 0 shares in the three months ended June 30, 2012 and 2011, respectively. We granted stock options for 50,000 and 0 shares in the six months ended June 30, 2012 and 2011, respectively. No SARs were granted in the three and six month periods ended June 30, 2012 and 2011.

Unrestricted Stock Grants - In July 2010, we granted 575,443 shares of stock to directors, officers and employees of which 111,163 shares were issued immediately and 464,280 shares were to be issued in four equal increments on December 31, 2010, June 30, 2011, December 31, 2011, and June 30, 2012; provided that grantees remain employed on each of those dates. We expensed \$94,000 and \$100,000 of stock-based compensation expense related to this grant in the three months ended June 30, 2012 and 2011, respectively. We expensed \$189,000 and \$246,000 of stock-based compensation expense related to this grant in the six months ended June 30, 2012 and 2011, respectively.

Shares issued in connection with the July 2010 stock grant were as follows in the six month periods ended June 30, 2012 and 2011:

Six months ended June 30, 2012 - We issued 76,906 shares on January 3, 2012 to officers and employees who were employed on December 31, 2011. Grantees were allowed to surrender a portion of their stock in return for the Company paying their related withholding taxes. As a result of this provision, grantees surrendered 12,153 shares of common stock and the Company paid approximately \$36,000 of withholding taxes on their behalf. After the share surrender, 64,753 net shares of common stock were issued.

On July 2, 2012, we issued the final installment of shares related to the July 2010 stock grant to officers and employees who were employed on June 30, 2012. We issued a total of 74,668 shares less 21,288 shares surrendered by employees for withholding taxes. After the share surrender, 53,380 net shares of common stock were issued.

Six months ended June 30, 2011 - We issued 115,682 shares on January 4, 2011 to officers and employees who were employed on December 31, 2010. Grantees surrendered 13,721 shares of common stock and the Company paid approximately \$39,000 of withholding taxes on their behalf. After the share surrender, 101,961 net shares of common stock were issued.

Our former President and CEO resigned in April 2011. As part of his separation arrangement he was granted 105,000 shares of common stock, which resulted in a stock-based compensation charge of \$362,000 in the three months ended June 30, 2011. His grant contained a provision that allowed him to surrender a portion of his stock in return for the Company paying his related withholding taxes. He exercised that provision, and we issued 71,662 shares of common stock to him and paid \$115,000 of withholding taxes on his behalf.

F) Business Segments. We organize ourselves into multiple segments reporting to the chief operating decision makers. Results of operations for our reportable segments were (in thousands):

	Segments			Total Company
	Biometrics & Imaging	DSL Service Assurance	Corporate	
Three Months Ended June 30, 2012				
Revenue	\$2,890	\$1,820	\$624	\$5,334
Income (loss) from operations	897	(262)	(266)	369
Gain on sale of patent assets			71,226	71,226
Other income			59	59
Interest income				