

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.

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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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CLEARONE, INC.

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

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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CLEARONE, INC.

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

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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CLEARONE, INC.

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

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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CLEARONE, INC.

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

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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CLEARONE, INC.

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

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)

