

Digimarc CORP
Form 10-K
February 20, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2014

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File Number 001-34108

DIGIMARC CORPORATION

(Exact name of registrant as specified in its charter)

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Oregon **26-2828185**
(State or other jurisdiction of **(I.R.S. Employer**
incorporation or organization) **Identification No.)**
9405 SW Gemini Drive, Beaverton, Oregon 97008
(Address of principal executive offices) (Zip Code)
(503) 469-4800
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$0.001 Par Value Per Share	The NASDAQ Stock Market LLC
Securities registered pursuant to Section 12(g) of the Act: NONE	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark 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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large 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

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The aggregate market value of common stock, par value \$0.001 per share, held by non-affiliates of the registrant, based on the closing price of our common stock on The Nasdaq Global Market on the last business day of the registrant's most recently completed fiscal second quarter (June 30, 2014), was approximately \$237 million. Shares of common stock beneficially held by each officer and director have been excluded from this computation because these persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purposes.

As of February 17, 2015, 8,507,800 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement pursuant to Regulation 14A (the Proxy Statement) for its 2015 annual meeting of shareholders are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this Annual Report on Form 10-K. The registrant intends to file the Proxy Statement not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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PART I

Unless the context otherwise requires, references in this Annual Report on Form 10-K to Digimarc, we, our and us refer to Digimarc Corporation.

All dollar amounts are in thousands except per share amounts or unless otherwise noted. Percentages within the following tables may not foot due to rounding.

Digimarc Discover, Digimarc Barcode and Digimarc Guardian are registered trademarks of Digimarc Corporation. This Annual Report on Form 10-K also includes trademarks and trade names owned by other parties, and all other such trademarks and trade names mentioned in this Annual Report on Form 10-K are the property of their respective owners.

ITEM 1: BUSINESS

The following discussion of Digimarc's business contains forward-looking statements relating to future events or the future financial performance of Digimarc. Our actual results could differ materially from those anticipated in these forward-looking statements. Please see the discussion regarding forward-looking statements included in this Annual Report on Form 10-K in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, under the caption Forward-Looking Statements.

The following discussion of our business should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Annual Report on Form 10-K.

Overview

Digimarc Corporation enables governments and enterprises around the world to give digital identities to media and objects that computers can sense and recognize and to which they can react. We have developed an intuitive computing platform that is intended to optimize the identification of consumer brand impressions, facilitating modern mobile-centric shopping. The platform includes means to infuse persistent digital information, Digimarc IDs, perceptible only to computers and digital devices, into all forms of media content, including consumer products packaging. Digimarc IDs for packaging, often referred to as Digimarc Barcodes facilitate remarkably faster scanning of items at retail checkout as well as improved interaction with consumers. The unique digital identifier placed in media generally persists with it regardless of the distribution path and whether it is copied, manipulated or converted to a different format, and does not affect the quality of the content or the enjoyment or other traditional uses of it. Our technology permits computers and digital devices to quickly identify relevant data from vast amounts of media content.

Our technologies, and those of our licensees, span numerous applications across a wide range of media content, enabling our customers and those of our partners to:

Improve the speed of retail checkout;

Provide simple and intuitive mobile customer engagement experiences in stores;

Quickly and reliably identify and effectively manage music, movies, television programming, digital images, e-books, documents and other printed materials, especially in light of non-linear distribution over the Internet;

Deter counterfeiting of money, media and goods, and piracy of e-books, movies and music;

Support new digital media distribution models and methods to monetize media content;

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Leverage the power of ubiquitous computing to instantly link consumers to a wealth of information and/or interactive experiences related to the media and objects they encounter each day;

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Provide consumers with more choice and access to media content when, where and how they want it;

Enhance imagery and video by associating metadata or authenticating media content for government and commercial uses; and

Better secure identity documents to enhance national security and combat identity theft and fraud.

At the core of our intellectual property is a signal processing innovation known as digital watermarking, which allows imperceptible digital information to be embedded in all forms of digitally designed, produced or distributed media content and some physical objects, including photographs, movies, music, television, personal identification documents, financial instruments, industrial parts and product packages. The digital information can be detected and read by a wide range of computers, mobile phones and other digital devices.

Our technology allows our customers to provide persistent digital identities for any media content that is digitally processed at some point during its lifecycle. The technology can be applied to printed materials, video, audio, and images. The inclusion of these digital signals enables a wide range of improvements in security and media management, and new business models for distribution and consumption of media content. Over the years our technology and intellectual property portfolios have grown to encompass many related technologies.

We provide solutions directly and through our licensees. Our proprietary technology has proven to be a powerful element of document security, giving rise to our long-term relationship with a consortium of central banks (Central Banks), and many leading companies in the information technology industry. We and our licensees have successfully propagated the use of our technology in music, movies, television broadcasts, images and printed materials. Digimarc IDs have been used in these applications to improve media rights and asset management, reduce piracy and counterfeiting losses, improve marketing programs, permit more efficient and effective distribution of valuable media content and enhance consumer entertainment and commercial experiences.

Banknote counterfeit deterrence was the first commercially successful large scale use of our technologies. Innovations based on our existing digital watermarking technology and experience have been leveraged to create new products to deter counterfeiting and tampering of driver licenses and other government-issued secure credentials. In parallel, our business partners, under patent or technology licenses from us, are delivering digital watermarking solutions to track and monitor the distribution of music, images, television and movies to consumers. In November of 2007, we announced a relationship with The Nielsen Company (US) LLC (Nielsen) to license our patents in support of Nielsen s industry leading television audience measurement solutions.

In October 2010, we entered into a patent licensing arrangement with IV Digital Multimedia Inventions, LLC, a Delaware limited liability company affiliated with Intellectual Ventures (IV), pursuant to which we granted an exclusive license to sublicense, subject to pre-existing encumbrances and a grant-back license, an aggregate of approximately 900 of the 1,200 patents and applications held by us at the time the agreement was entered into, as noted below in the section titled Technology and Intellectual Property. Some of the patents exclusively licensed to IV have expired, while additional patents have been filed, bringing the total number of active patent assets licensed to IV to approximately 680.

In December 2012, we acquired Attributor Corporation (Attributor), a leader in protecting e-books from online piracy. Attributor s services have been rebranded Digimarc Guardian and protect book revenue and authors rights by finding, reporting on, and assisting in removing pirated content found on the Internet.

Also in December 2012, we entered into a renewal and extension through 2024 of the Counterfeit Deterrence System Development and License Agreement with the Central Banks, with a 5 year extension option.

Financial information about geographic areas is included in Note 5 of our Notes to Consolidated Financial Statements.

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Customers and Business Partners

Our revenue is generated through commercial and government applications of our technology. We derive our revenue primarily from development services, subscriptions for products and services, and licensing of our technology and patents. During 2014, we generated the majority of our revenue from development services under a long-term contract with the Central Banks and license fees and royalties paid to us by Verance Corporation (Verance), Civolution and Nielsen. The remainder of our revenue was largely comprised of subscription fees for products and services provided to a large range of customers.

In 2014, revenue from government contracts accounted for 47% of our total revenue, and revenue generated under our contract with the Central Banks accounted for substantially all of the revenue generated under our government contracts. Our government contracts typically span one or more base years and multiple option years. Government customers generally have the right to not exercise option periods. As part of our work with government customers, we must comply with and are affected by laws and regulations relating to the award, administration and performance of government contracts. Government contract laws and regulations affect how we do business with our government customers and, in some instances, impose added costs on our business.

Information about customers that accounted for 10% or more of revenue in the last three years is included in Note 5 of our Notes to Consolidated Financial Statements.

Products and Services

We provide media identification and management solutions to commercial entities and government customers and license our technology and patent inventions to other solution providers. Our largest government customer is the Central Banks, with whom we have for the last 16 years been developing, deploying, supporting and continuing to enhance a system to deter digital counterfeiting of currency using personal computers and digital reprographics. We license primarily to commercial entities who use our technology and patented inventions in the media and entertainment industry. Commercial customers use a range of solutions from our business partners and us to identify, track, manage and protect content as it is distributed and consumed either digitally or physically and to enable new consumer applications to access networks and information from personal computers and mobile devices. Many movie studios, record labels, broadcasters, creative professionals and other customers rely on digital watermarking as a cost-effective means to:

deter piracy and illegal use of movies, music and images;

protect entertainment content from copyright infringement;

track and monitor entertainment content for rights usage and licensing compliance;

monitor advertisements to verify ad placement and measure return on investment;

enhance information access, search and marketing capabilities related to media content; and

enable fair and legitimate use of content by consumers.

Digimarc IDs are easily embedded into all forms of media and are imperceptible to human senses, but quickly detected by computers, networks or other digital devices like smartphones. Unlike traditional barcodes and tags, our solution does not require publishers to give up valuable space in magazines and newspapers; nor does it impact the overall layout or aesthetics of the publication. Our Digimarc Discover platform delivers a range of rich media experiences to its readers on their smartphones across multiple media including print, audio, video and packaging. Unique to the Digimarc Discover platform is its ability to use various content identification technologies as needed, including our patented technology.

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We introduced Digimarc Barcodes as a feature of Digimarc Discover in 2014. Digimarc Barcodes contain the same information found in traditional universal product codes (UPC). The UPC information is invisibly repeated multiple times over the entire package surface. We partnered with Datalogic, a global leader in

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Automatic Data Capture and Industrial Automation markets and producer of barcode readers, in bringing the Digimarc Barcode to the market. The first retail scanner enabled was Datalogic's MagellanTM 9800i multi-plane imaging scanner. Digimarc Barcodes can also connect mobile-enabled consumers directly from packaging to engaging mobile experiences such as additional product information, special offers, recommendations, reviews, social networks and more.

As part of our intellectual property marketing and patent monetization efforts, our key objectives in building relationships with potential customers and partners are to:

make progress toward the realization of our vision to enrich everyday living via pervasive, intuitive computing;

expand the scope of our license program;

effectively monetize our patent assets;

encourage large scale adoption of our technologies by industry leaders;

improve our financial performance;

increase the scale and rate of growth of our products and services business; and

lay a foundation for continuing innovation.

Current patent licensees include, among others, IV, Nielsen, Verance, Civolution, AlpVision SA, Monic, Signum Technologies and Verimatrix.

Technology and Intellectual Property

We develop intellectual property to differentiate our products and technology, mitigate infringement risks, and develop opportunities for licensing. Our broad patent portfolio covers a wide range of methods, applications, system architectures and business processes.

Most of our patents relate to various methods for embedding and decoding digital information in video, audio and images, whether the content is rendered in analog or digital formats. The digital information is generally embedded by making subtle modifications to the fundamental elements of the content itself, generally at a signal processing level. The changes necessary to embed this information are so subtle that they are generally not noticeable by people during normal use. Because the message is carried by the content itself, it is file-format independent. The embedded digital information generally survives most normal content transformations, including compression, edits, rotation, scaling, re-sampling, file-format transformations, copying, scanning and printing.

Our patent portfolio contains a number of innovations in digital watermarking, pattern recognition (sometimes referred to as fingerprinting), digital rights management and related fields. To protect our significant efforts in creating our technology, we have implemented an extensive intellectual property protection program that relies on a combination of patent, copyright, trademark and trade secret laws, and nondisclosure agreements and other contracts. As a result, we believe we have one of the world's most extensive patent portfolios in digital watermarking and related fields, with more than 1,200 U.S. and foreign patents and pending patent applications as of December 31, 2014. We continue to develop and broaden our portfolio of patented technology in the fields of media identification and management technology and related applications and systems. We devote significant resources to developing and protecting our inventions and continuously seek to identify and evaluate potential licensees for our patents. The patents in our portfolio have a life of approximately 20 years from the effective filing date, and up to 17 years after the patent has been granted.

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For a discussion of activities and costs related to our research and development in the last three years, please read Research, development and engineering under Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

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Markets

Our patented inventions are used in various media identification and management products and solutions supporting a variety of media objects, from movies and music to banknotes, secure credentials and consumer packaged goods. Each media object enabled by our inventions creates the potential for several applications, such as:

counterfeiting and piracy deterrence;

online e-book piracy protection;

content identification and media management;

authentication and monitoring;

retail point of sale transaction processing;

linking to networks and providing access to information; and

enhanced services in support of mobile commerce.

We believe the market for most of these applications is in the early stages of development and that existing solutions represent only a small portion of the potential market for our products, services and technology.

Competition

No single competitor or small number of competitors dominate our market. Our competitors vary depending on the application of our products and services. Our business partners and we generally compete with non-digital watermarking technologies for the security or marketing budgets of the producers and distributors of media objects, documents, products and advertising. These alternatives include, among other things, encryption-based security systems and technologies and solutions based on fingerprinting, pattern recognition, and traditional barcodes. Our competitive position in digital watermarking applications is strong because of our large, high quality, sophisticated patent portfolio and our substantial and growing amount of intellectual property in related media security and management innovations that span basic technologies, applications, system designs and business processes. Our intellectual property portfolio allows us to use proprietary technologies that are well regarded by our customers and partners and not available to our competitors. We compete based on the variety of features we offer and a traditional cost/benefit analysis against alternative technologies and solutions. We anticipate that our competitive position within some markets may be affected by factors such as reluctance to adopt new technologies and by changes in government regulations.

Backlog

Based on projected commitments we have for the periods under contract with our respective customers, we anticipate our current contracts as of December 31, 2014 will generate a minimum of \$29 million in revenue. We expect approximately \$17 million of this amount to be recognized as revenue during 2015.

Some factors that lead to increased backlog include:

contracts with new customers;

renewals with current customers;

add-on orders with customers; and

contracts with longer contractual periods replacing contracts with shorter contractual periods.
Some factors that lead to decreased backlog include:

recognition of revenue associated with backlog currently in place;

contracts with shorter contractual periods replacing contracts with longer contractual periods;

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modifications to existing contracts;

contract minimum payments ending; and

expiration of contracts with existing customers.

The mix of these factors, among others, dictates whether our backlog increases or decreases for any given period. Our backlog may not result in actual revenue in any particular period, because the orders, awards and contracts included in our backlog may be subject to modification, cancellation or suspension. We may not realize revenue on certain contracts, orders or awards included in our backlog or the timing of any realization may change.

Employees

At December 31, 2014, we had 150 full-time employees, including 37 in sales, marketing, technical support and customer support; 87 in research, development and engineering, including intellectual property; and 26 in finance, administration, information technology and legal.

Our employees are not covered by any collective bargaining agreement, and we have never experienced a work stoppage. We believe that our relations with our employees are good.

Available Information

We make available free of charge through our website at www.digimarc.com our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these and other reports filed or furnished by us pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we file these materials with the Securities and Exchange Commission.

ITEM 1A: RISKFACTORS

The following risk factors are those risks of which we are aware and that we consider to be material to our business. If any of the following risks and uncertainties develops into actual events, our business, financial condition or results of operations and cash flows could be materially adversely affected. In that case, the trading price of our common stock could decline. Additionally, we cannot be certain or give any assurance that any actions taken to reduce known risks and uncertainties will be effective.

RISKS RELATED TO OUR BUSINESS

(1) A small number of customers account for a substantial portion of our revenue, and the loss of any large contract could materially disrupt our business.

Historically, we have derived a significant portion of our revenue from a limited number of customers. Five customers, the Central Banks, Verance, Civolution, Nielsen and IV represented approximately 73% of our revenue for the year ended December 31, 2014. Most of our revenue comes from long-term contracts generally having terms of at least three to five years, with some licenses for the life of the associated patents, which could be up to 20 years. The agreements with our licensees generally provide for minimum and/or variable payment obligations. The minimum license fee payment obligations under our license agreement with IV ended in 2013 and all payment obligations under our license agreements with Nielsen and Verance ended in 2014. Some contracts we enter into contain termination for convenience provisions. If we were to lose such a contract for any reason, or if revenue from variable payment obligations do not replace revenue under the existing fixed payment obligations, our financial results could be adversely affected.

We expect to continue to depend upon a small number of customers for a significant portion of our revenue for the foreseeable future. The loss of, or decline in, orders or backlog from one or more major customers could reduce our revenue and have a material adverse effect on our financial results.

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(2) Although we achieved profitability in prior years, we were not profitable in 2013 or 2014 and may not be able to return to or sustain profitability in the future, particularly if we were to lose large contracts. Sustained lack of profitability could cause us to incur asset impairment charges for long-lived assets and/or record valuation allowance against our deferred tax assets.

We incurred net losses in 2013 and 2014 largely due to increased level of investments in our business to support our product development and sales growth initiatives and the scheduled completion of the quarterly license fee payments from IV in the second quarter of 2013 and Nielsen in the first quarter of 2014.

Returning to and maintaining profitability in the future will depend upon a variety of factors, including our ability to maintain and obtain more significant partnerships like we have with the Central Banks and acquiring new customers for Digimarc Discover, Barcode and Guardian and future licensees. Profitability will also depend on growth in revenue from our efficiency in executing our business strategy and capitalizing on new opportunities. Various adverse developments, including the loss of large contracts or cost overruns on our existing contracts, could adversely affect our revenue, margins and profitability.

If we continue to incur operating losses, it could result in an impairment to the carrying value of our long-lived assets, including goodwill, acquired intangible assets, patent assets and property and equipment. We evaluate impairment of our long-lived assets when events or changes in circumstances indicate that the carrying value may not be recoverable. Our methodology for assessing impairment may require management to make judgments and assumptions regarding future cash flows. Our projections of future cash flows are largely based on historical experience, and these projections may or may not be achieved. Changes to these financial projections used in our impairment analysis could lead to an impairment of all or a portion of our long-lived assets. Any such impairment charge could adversely affect our results of operations and our stock price. We concluded a triggering event occurred during the fourth quarter of 2014, due to operating losses in 2013 and 2014 and a projected operating loss in 2015. Accordingly, we tested our long-lived assets for impairment as of December 31, 2014. We concluded that no impairment existed as the projected net undiscounted cash flows from our long-lived assets significantly exceeded their book value. We cannot guarantee however that our projected net undiscounted cash flows from our long-lived assets will continue to exceed their carrying value.

We record valuation allowances on our deferred tax assets if, based on available evidence, it is more-likely-than-not that all or some portion of the assets will not be realized. The determination of whether our deferred tax assets are realizable requires management to identify and weight all available positive and negative evidence. Management considers recent financial performance, projected future taxable income, scheduled reversals of deferred tax liabilities, tax planning strategies and other evidence in assessing the realizability of our deferred tax assets. Adjustments to our deferred tax assets could adversely affect our results of operations and our stock price. We recorded a \$6.8 million non-cash income tax charge during the fourth quarter of 2014 to record a full valuation allowance against our deferred tax assets largely due to the cumulative loss we have incurred over the last three years, which is considered a significant piece of negative evidence in assessing the realizability of deferred tax assets. We will not record tax benefits on any future losses until its determined that those tax benefits will be realized.

(3) We may be adversely affected by variability of contracted arrangements.

We frequently have agreed to modify the terms of contractual arrangements with our customers, partners and licensees in response to changes in circumstances underlying the original contractual arrangements, and it is likely that we will do so in the future. For example, in the third quarter of 2014 we extended our existing patent license agreement with Verance through 2023 in effect waiving any future royalties and license fees in exchange for a \$1.0 million license fee payment. As a result of this practice, the terms of our contractual arrangements with our customers, partners and licensees may vary over time and, depending on the particular modification, could have a material adverse effect on our financial position, results of operations or cash flows.

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Some of our customers and licensees report royalties to us based on their revenue and their interpretation and allocation of contracted royalty obligations. For example, one licensee reports profit sharing to us based on income earned, which is subject to their interpretation and allocation of revenue and expenses, which could be less favorable to us than our own interpretation. It is possible that we may not agree with the judgments of our customers on such matters, and such disagreement may lead to potential disputes and reduced revenue to us. These disputes could result in a distraction to our management and may not result in increased revenues to us but may nevertheless result in friction between us and our customers, and potentially the loss of customers, which may ultimately be harmful to our business.

(4) A significant portion of our current and potential future revenue is subject to commercial and government contracts and development of new markets that may involve unpredictable delays and other unexpected changes. Such volatility and uncertainty might limit our actual revenue in any given quarter or year.

We derive substantial portions of our revenue from contracts tied to development schedules or development of new markets, which could shift for months, quarters or years as the needs of our customers and the markets in which they participate change. Government agencies and commercial customers also face budget pressures that introduce added uncertainty. Any shift in development schedules, the markets in which we or our licensees participate, or customer procurement processes, which are outside our control and may not be predictable, could result in delays in bookings forecasted for any particular period, could affect the predictability of our quarterly and annual results, and might limit our actual revenue in any given quarter or year, resulting in reduced and less predictable revenue and adversely affecting profitability.

We are also expanding into new markets, which involve inherent risk and unpredictability. In recent years, particularly with the proliferation of smartphones and increased demands for enhanced security options, we have investigated other technologies that may provide attractive future opportunities, for example in the packaging and publishing markets. These generally include technologies that leverage our strength in signal processing and support our vision for intuitive, pervasive computing. As we seek to expand outside our areas of historical expertise, we lack the history and insight that benefited us in the watermarking field. We also lack the size and scale typical of contractors providing products and services to the federal government. Although we have extensive experience in the commercial application of digital watermarking, we are investing in but may not be as well-positioned in these other disciplines. Accordingly, it may be difficult for us to replicate our watermarking success in other technologies we might pursue.

(5) The market for our products is highly competitive, and alternative technologies or larger companies that compete with us may be more successful than us in gaining market share, which would decrease our revenue and profits.

The markets in which we compete for business are intensely competitive and rapidly evolving. We expect competition to continue from both existing competitors and new market entrants. We face competition from other companies and from alternative technologies, including some of our customers and licensees. We also may face competition from unexpected sources.

Alternative technologies that may directly or indirectly compete with particular applications of our watermarking technologies include:

Traditional anti-counterfeiting technologies a number of solutions used by many government agencies (that compete for budgetary outlays) designed to deter counterfeiting, including optically sensitive ink, magnetic threads and other materials used in the printing of currencies;

Image recognition one or several pre-specified or learned objects or object classes that can be recognized, usually together with their two-dimensional positions in the image or three-dimensional poses in the scene, such as Amazon Firefly or Qualcomm Vuforia, which provides a stand-alone program illustration of this function;

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Radio frequency tags embedding a chip that emits a signal when in close proximity with a receiver, used in some photo identification credentials, labels and tags;

Internet technologies numerous existing and potential Internet access and search methods are competitive with Digimarc Mobile systems and the searching capabilities of Digimarc Guardian;

Digital fingerprints and signatures a metric, or metrics, computed solely from a source image or audio or video track, that can be used to identify an image or track, or authenticate the image or track; and

Bar codes or QR codes data-carrying codes, typically visible in nature (but may be invisible if printed in ultraviolet- or infrared-responsive inks).

In the competitive environments in which we operate, product generation, development and marketing processes relating to technology are uncertain and complex, and require accurate prediction of demand as well as successful management of various risks inherent in technology development. In light of these uncertainties, it is possible that our failure to successfully accommodate future changes in technologies related to our technology could have a long-term negative effect on our growth and results of operations.

New developments are expected to continue, and discoveries by others, including current and potential competitors, possibly could render our services and products noncompetitive. Moreover, because of rapid technological changes, we may be required to expend greater amounts of time and money than anticipated to develop new products and services, which in turn may require greater revenue streams from those products and services to cover developmental costs. Many of the companies that compete with us for some of our business, as well as other companies with whom we may compete in the future, are larger and may have stronger brand recognition and greater technical, financial, marketing and political resources than we do. These attributes could enable these companies to have more success in the market than we have, either by providing better products or better pricing than we can provide. We may be unable to compete successfully against current or future participants in our market or against alternative technologies, and the competitive pressures we face could decrease our revenue and profits in the future.

(6) We may not receive any profit-sharing from our patent licensing arrangement with Intellectual Ventures.

In connection with our patent licensing arrangement with IV, we granted an exclusive license to sublicense our patent assets existing at that time to IV in exchange for various strategic and financial benefits, including profit participation. We have received all of the minimum guaranteed license fees and the minimum consulting fees conclude in 2015. We may not realize any profit participation revenue from our patent licensing arrangement with IV. We have given IV control over both prosecution and enforcement of these assets. While IV can seek our assistance and has committed to pay for it, we cannot guarantee that IV will seek our assistance in prosecution, nor enforce the patents to the extent we would.

(7) We may acquire or invest in other companies or technologies in the future, which could divert management's attention, result in additional dilution to our stockholders, increase expenses, disrupt our operations and harm our operating results.

We acquired Contributor Corporation in December 2012, and we may in the future acquire or invest in businesses, products or technologies that we believe could complement or expand our current product and service offerings, enhance our technical capabilities, expand our operations into new markets or otherwise offer growth opportunities. We cannot assure you that we will realize the anticipated benefits of our acquisition of Contributor or any future acquisition. The pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses related to identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated.

There are inherent risks in integrating and managing acquisitions. We may not be able to assimilate or integrate the acquired personnel, operations and technologies successfully or effectively manage the combined

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business following an acquisition. We also may not achieve the anticipated benefits from an acquired business due to a number of factors, including:

unanticipated costs or liabilities associated with the acquisition;

incurrence of acquisition-related costs, which would be recognized as a current period expense;

inability to generate sufficient revenue to offset acquisition or investment costs;

the inability to maintain relationships with customers and partners of the acquired business;

the need to implement additional controls, procedures and policies;

entry into geographic markets in which we have little or no prior experience, and challenges caused by distance, language and cultural differences;

differences in foreign labor and employment laws, including classification of employees and contractors;

disruption of our ongoing business;

the potential loss of key employees; and

use of substantial portions of our available cash to consummate the acquisition.

Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. In addition, if an acquired business fails to meet our expectations, our operating results, business and financial condition may suffer.

(8) An increase in our operations outside of the U.S. subjects us to risks additional to those to which we are exposed in our domestic operations.

We believe that revenue from sales of products and services to commercial, governmental and other customers outside the U.S. could represent a growing percentage of our total revenue in the future. In addition, as a result of our acquisition of Attributor Corporation, we perform certain functions in various jurisdictions outside of the U.S. International operations are subject to a number of risks that can adversely affect our sales of products and services to customers outside of the U.S., or expose us to additional expense or liabilities, including the following:

difficulties and costs of staffing, developing and managing foreign operations as a result of distance, language and cultural differences;

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the effect of laws governing employee and contractor relationships, and the existence of workers' councils and labor unions in some jurisdictions;

changes in foreign government regulations and security requirements;

export license requirements, tariffs and taxes;

trade barriers;

difficulty in protecting intellectual property;

difficulty in collecting accounts receivable;

currency fluctuations;

longer payment cycles than those for customers in the U.S; and

political and economic instability.

We do not have an extensive operational infrastructure for international business. We generally depend on local or international business partners and subcontractors for performance of substantial portions of our business. These factors may result in greater risk of performance problems or of reduced profitability with

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respect to our international programs in these markets. In addition, if foreign customers, in particular foreign government authorities, terminate or delay the implementation of our products and services, it may be difficult for us, or we may not be able, to recover our potential losses.

(9) Our future growth will depend to some extent on our successful implementation of our technology in solutions provided by third parties.

Our business and strategy rely substantially on deployment of our technology by our licensees and other third-party software developers and original equipment manufacturers. For example, one form of our technology is commonly deployed in image editing applications to permit users of these products to read data embedded in imagery, and thereby identify ownership and discern the identities of image owners. Another form of our technology is used in our anti-counterfeiting products. Our patented inventions are also being deployed as part of Digital Cinema systems to theatres around the world by companies that integrate technologies and subsystems. Most recently, our software has been integrated into point of sale scanners from Datalogic. If third parties who include our technology in their products or otherwise license our intellectual property for use in their products cease to do so, or we fail to obtain other partners who will incorporate, embed, integrate or bundle our technology, or these partners are unsuccessful in their efforts, our efforts to expand deployment of our technology and increase licensing revenue would be adversely affected. Consequently, our ability to increase revenue would be adversely affected and we may suffer other adverse effects to our business. In addition, if our technology does not perform according to market expectations, our future sales would suffer as customers seek other alternatives.

(10) We depend on our management and key employees for our future success. If we are not able to retain, hire or integrate these employees, we may not be able to meet our commitments.

Our success depends to a significant extent on the performance and continued service of our management and our intellectual property team. The loss of the services of any of these employees could limit our growth or undermine customer relationships.

Due to the high level of technical expertise that our industry requires, our ability to successfully develop, market, sell, license and support our products, services, and intellectual property depends to a significant degree upon the continued contributions of our key personnel in engineering, sales, marketing, operations, legal and licensing, many of whom would be difficult to replace. We believe our future success will depend in large part upon our ability to retain our current key employees and our ability to attract, integrate and retain new personnel in the future. It may not be practical for us to match the compensation some of our employees could garner at other employment. In addition, we may encounter difficulties in hiring and retaining employees because of concerns related to our financial performance or operating results. These circumstances may have a negative effect on the market price of our common stock, and employees and prospective employees may factor in the uncertainties relating to our stability and the value of any equity-based incentives in their decisions regarding employment opportunities and decide to leave our employ. Moreover, our business is based in large part on patented technology, which is a unique and sophisticated signal processing technology. New employees require substantial training, involving significant resources and management attention. Competition for experienced personnel in our business can be intense. If we do not succeed in attracting new, qualified personnel or in integrating, retaining and motivating our current personnel, our growth and ability to deliver products and services that our customers require may be hampered. Although our employees generally have executed agreements containing non-competition clauses, we do not assure you that a court would enforce all of the terms of these clauses or the agreements generally. If these clauses were not fully enforced, our employees could freely join our competitors. Although we generally attempt to control access to and distribution of our proprietary information by our employees, we do not assure you that the confidential nature of our proprietary information will be maintained in the course of such future employment. Any of these events could have a material adverse effect on our financial and business prospects.

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(11) If leading companies in the retail and consumer products industries or standard-setting bodies or institutions downplay, minimize or reject the use of our technology, deployment may be slowed and we may be unable to achieve revenue growth.

Many of our business endeavors, including the Digimarc Barcode, can be impeded or frustrated by larger, more influential companies or by standard-setting bodies or institutions downplaying, minimizing or rejecting the value or use of our technology. A negative position by these companies, bodies or institutions, if taken, may result in obstacles for us that we would be incapable of overcoming and may block or impede the adoption of our technology. In addition, potential customers may delay or reject initiatives that relate to deployment of our technology. Such a development would make the achievement of our business objectives in this market difficult or impossible.

(12) We are subject to risks encountered by companies developing and relying upon new technologies, products and services for substantial amounts of their growth or revenue.

Our business and prospects must be considered in light of the risks and uncertainties to which companies with new and rapidly evolving technology, products and services are exposed. These risks include the following:

we may be unable to develop sources of new revenue or sustainable growth in revenue because our current and anticipated technologies, products and services may be inadequate or may be unable to attract or retain customers;

intense competition and rapid technological change could adversely affect the market's acceptance of our existing and new products and services;

we may be unable to develop and maintain new technologies upon which our existing and new products and services are dependent which may cause our products and services to be less sustainable and competitive or which could make it harder for us to expand our revenue and business; and

our licensees may not be able to successfully enter new markets or grow their businesses, limiting the royalties payable to us and our associated revenue and profits.

Some of our key technology and solutions from our patent or technology licensees are in the development stage. Consequently, products incorporating our technology and solutions are undergoing technological change and are in the early stages of introduction in the marketplace. Delays in the adoption of these products or adverse competitive developments may result in delays in the development of new revenue sources or the growth in our revenue. In addition, we may be required to incur unanticipated expenditures if product changes or improvements are required. Moreover, new industry standards might redefine the products that we or our licensees are able to sell, especially if these products are only in the prototype stage of development. If product changes or improvements are required, success in marketing these products by us or our licensees and achieving profitability from these products could be delayed or halted. We also may be required to fund any changes or improvements out of operating income, which could adversely affect our profitability.

(13) (a) We may not be able to adequately secure patent or other protection for our technologies.

Our business depends in part on securing protection for our proprietary technology and successfully licensing our technology to third parties. To protect our intellectual property portfolio, we rely on a combination of patent, copyright, trademark and trade secret rights, confidentiality procedures and licensing arrangements. Although we regularly apply for patents, copyrights and trademarks to protect our intellectual property, there is no guarantee that we will secure protection for any particular technology we develop. In particular, the process of securing a patent is complex and may take several years in the United States. To secure patent protection, among other things, our invention must be novel and useful, we must be the first to file a patent application, we must secure the cooperation of the inventor of the invention that is the subject of the patent and we must prepare and file the patent application with the relevant U.S. or foreign patent offices. During the process, third parties, including our competitors, can challenge and seek to limit any patent claims we seek. Even if we are successful

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in obtaining a patent, the scope of the patent may not be as broad as our claims in our patent application. Furthermore, patent protection throughout the world is generally established on a country-by-country basis and we may not have as much success in securing patents in foreign jurisdictions as we have experienced in the United States. We cannot assure you that pending patents will be issued or that issued patents will be valid or enforceable. Failure to secure the issuance of patents for which we have filed applications or failure to enforce patents that are issued may result in less future revenue to us.

Changes in the U.S. and foreign patent laws, or in the interpretation of existing laws, may adversely affect our ability to secure patents as well. An example includes the passage of the America Invents Act of 2011, which codifies several significant changes to the U.S. patent laws, including changing from a first to invent to a first inventor to file system, limiting where a patentee may file a patent suit, replacing interference proceedings with derivation actions, and creating a post-grant opposition process to challenge patents after they have issued.

Even if we are successful in securing patent protection for any particular technology, patents have finite lives, and our ability to continue to commercially exploit our patents is limited to the term of the patents. Our earliest patents began expiring in July 2012. The size and strength of our portfolio depends on the number of patents that have been granted, offset by the number of patents that expire, in any given year. We continue to grow our patent portfolio, but we do not assure you that we will be able to exploit newer patents to the extent that we have our earlier patents.

Third parties may petition the U.S. Patent and Trademark Office or comparable government authorities in other jurisdictions to review and reconsider the patentability of any of our inventions claimed in our issued patents. Any such re-examination may result in one or more of our patents becoming more limited, or being invalidated altogether. Such reexaminations, post grant reviews, associated government or judicial hearings, and potentially adverse decisions may cause us increased expense and distraction, and may negatively impede any licensing discussions we are then engaged in with respect to such patents, and may adversely affect any existing licenses we have granted with respect to such patents, thus impacting adversely our revenues.

As part of our confidentiality procedures, we generally enter into non-disclosure agreements with our employees, directors, consultants and corporate partners, and attempt to control access to and distribution of our technology, solutions, documentation and other proprietary information. Despite these procedures, third parties could copy or otherwise obtain and make unauthorized use of our technology, solutions or other proprietary information or independently develop similar technologies, solutions or information. The steps that we have taken to prevent misappropriation of our solutions, technology or other proprietary information may not succeed.

We do not assure you that the protection of our proprietary rights will be adequate or that our competitors will not independently develop similar technologies, duplicate our services or design around any of our patents or other intellectual property rights.

(b) We may not be successful in enforcing our intellectual property rights against third parties.

Unlicensed copying and use of our intellectual property or infringement of our intellectual property rights may result in the loss of revenue to us and cause us other harm. We seek diligently to enforce our intellectual property rights. Although we devote significant resources to developing and protecting our technologies, and evaluating potential competitors of our technologies for infringement of our intellectual property rights, these infringements may nonetheless go undetected or may arise in the future. In the ordinary course of business, we encounter companies that we believe are infringing on our intellectual property rights. When we encounter a company that we believe is infringing our intellectual property rights, we may try to negotiate a license arrangement with such party. If we try and are unable to negotiate a license or secure the agreement of such alleged infringing party to cease its activities, we must make decisions as to how best to enforce our intellectual property rights.

The process of negotiating a license with a third party can be lengthy, and may take months or even years in some circumstances. Even if we are successful in securing a license agreement, there can be no assurance that

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our technologies will be used in a product that is ultimately brought to market, achieves commercial acceptance or results in significant royalties to us. We generally incur expense prior to entering into our license agreements, generating a license fee and establishing a royalty stream from each customer. We may incur costs in any particular period before any associated revenue stream begins, if at all. Further, it is possible that third parties who we believe are infringing our intellectual property rights are unwilling to license our intellectual property from us on terms we can accept, or at all.

If we cannot persuade a third party who we believe is infringing our technology to enter into a license with us, we may be required to consider other alternatives to enforce our rights, including commencing litigation. The decision to commence litigation over infringement of a patent is complex and may lead to several risks to us, including the following, among others:

the time, significant expense and distraction to management of managing such litigation;

the uncertainty of litigation and its potential outcomes;

the possibility that in the course of such litigation, the defendant may challenge the validity of our patents, which could result in a re-examination or post grant review of our patents and the possibility that our patents may be limited in scope or invalidated altogether;

the potential that the defendant may successfully persuade a court that their technology or products do not infringe our intellectual property rights;

the impact of such litigation on other licensing relationships we have or seek to establish, including the timing of renewing or entering into such relationships, as applicable, as well as the terms of such relationships; and

adverse publicity to us or harm to relationships we have with customers or others.

Further, we are the exclusive licensee under some third-party patents, and may need the assistance of these parties if we choose to enforce any of these patent rights. The cooperation of these third parties cannot be assured.

Also, enforcement of patent protection throughout the world is generally established on a country-by-country basis and we may not have as much success enforcing our patents in foreign jurisdictions as we have experienced in the United States. Further, in some instances, certain foreign governmental entities that might infringe our intellectual property rights may enjoy sovereign immunity from such claims. Consequently, effective protection of our intellectual property rights may be unavailable or limited.

Defendants in any litigation we consider commencing may have substantially greater financial and management resources necessary to manage litigation than we have. Further, such potential defendants may also have their own substantial patent portfolio. Patent litigation can endure for years and result in millions of dollars of expenses. If our counterparties in such litigation have substantially greater resources than we have, we may not be able to withstand the time, expense or distraction of the litigation, even though we may have a better litigation position than such counterparties. In such instances we may not recover the expenses of litigation, and we may be required to enter into settlement agreements that would be adverse to us or our intellectual property portfolio. From time to time, we contemplate, and are currently contemplating, litigation against companies that we believe to be infringing upon our intellectual property. Some of these companies we know to have extremely significant cash and legal resources focused on the development and enforcement of their intellectual property portfolios. Should we commence litigation against one or more of those parties, we expect that we will be required to devote substantial resources and funds to such litigation and we may not be successful in recouping such resources.

The foregoing and other factors may cause us not to file or continue litigation against alleged infringers of our intellectual property rights, or may cause us not to file for, or pursue, patent protection for our inventive technology, in certain jurisdictions. Our failure to seek to enforce our intellectual property rights may weaken our

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ability to enforce our intellectual property in the future or make our efforts to license our intellectual property rights more difficult.

If we fail to protect our intellectual property rights adequately, if there are adverse changes in applicable laws, or if we become involved in litigation relating to our intellectual property rights or the intellectual property rights of others, our business could be seriously harmed. In such cases, the value ascribed to our intellectual property could diminish, we may incur significant legal expenses that could harm our results of operations and our patents or other intellectual property rights may be limited or invalidated. Any of the foregoing could have a negative effect on the value of our common stock.

(c) We may be subject to infringement claims and other litigation, which could adversely affect our business.

As more companies engage in business activities relating to digital watermarking, and develop corresponding intellectual property rights, it is increasingly likely that claims may arise which assert that some of our products or services infringe upon other parties' intellectual property rights. These claims could subject us to costly litigation and divert management resources. These claims may require us to pay significant damages, cease production of infringing products, terminate our use of infringing technology or develop non-infringing technologies. In these circumstances, continued use of our technology may require that we acquire licenses to the intellectual property that is the subject of the alleged infringement, and we might not be able to obtain these licenses on commercially reasonable terms or at all. Our use of protected technology may result in liability that threatens our continuing operation.

Some of our contracts include indemnity and similar provisions regarding our non-infringement of third-party intellectual property rights. As deployment of our technology increases, and more companies enter our markets, the likelihood of a third party lawsuit resulting from these provisions increases. If an infringement arose in a context governed by such a contract, we may have to refund to our customer amounts already paid to us or pay significant damages, or we may be sued by the party whose intellectual property has allegedly been infringed upon.

(d) Governmental regulation of non-practicing patent holders may adversely affect our business.

Governmental policymakers and commercial participants have proposed reforming U.S. patent laws and regulations in a manner that may limit a patent-holder's ability to enforce its patents against others to the extent that the holder is not practicing the subject matter of the patent at issue. The U.S. International Trade Commission has also recently taken certain actions that have been viewed as unfavorable to patentees seeking recourse in this forum. While we cannot predict what form any new patent reform laws or regulations may ultimately take, or what impact they may have on our business, any laws or regulations that restrict our ability to enforce our patent rights against third parties could have a material adverse effect on our business.

(14) If our revenue models and pricing structures relating to products and services that are under development do not gain market acceptance, the products and services may fail to attract or retain customers and we may not be able to generate new revenue or sustain existing revenue.

Some of our business involves embedding digital watermarks in traditional and digital media, including consumer product packaging and related marketing materials, secure documents, audio, video and imagery, and licensing our intellectual property. Our revenues result from a combination of development, consulting, subscription and license fees from a variety of media identification and management applications. We launched Digimarc Discover in 2011 and the Digimarc Barcode in 2014, both of which incorporate new business and pricing models for licensing access to our online services portal. We have not fully developed revenue models for some applications and licensing endeavors. Because some of our products and services are not yet well-established in the marketplace, and because some of these products and services will not directly displace

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existing solutions, we cannot be certain that the pricing structure for these products and services will gain market acceptance or be sustainable over time or that the marketing for these products and services will be effective.

(15) If we are unable to respond to regulatory or industry standards effectively, or if we are unable to develop and integrate new technologies effectively, our growth and the development of our products and services could be delayed or limited.

Our future success will depend in part on our ability to enhance and improve the responsiveness, functionality and features of our products and services, and those of our business partners, in accordance with regulatory or industry standards. Our ability to remain competitive will depend in part on our ability to influence and respond to emerging industry and governmental standards in a timely and cost-effective manner. If we are unable to influence these or other standards or respond to these standards effectively, our growth and the development of various products and services could be delayed or limited.

Our market is characterized by new and evolving technologies. The success of our business will depend on our ability to develop and integrate new technologies effectively and address the increasingly sophisticated technological needs of our customers in a timely and cost-effective manner. Our ability to remain competitive will depend in part on our ability to:

enhance and improve the responsiveness, functionality and other features of the products and services we offer or plan to offer;

continue to develop our technical expertise; and

develop and introduce new services, applications and technologies to meet changing customer needs and preferences and to integrate new technologies.

We do not assure you that we will be successful in responding to these technological and industry challenges in a timely and cost-effective manner. If we are unable to develop or integrate new technologies effectively or respond to these changing needs, our margins could decrease, and our release of new products and services and the deployment of our technology could be adversely affected.

(16) We may need to retain additional employees or contract labor in the future in order to take advantage of new business opportunities arising from increased demand, which could increase costs and impede our ability to achieve or sustain profitability in the short term.

We have staffed our company with the intent of accelerating our product development and sales growth initiatives while also focusing on achieving and sustaining profitability. Our current staffing levels could affect our ability to respond to increased demand for our services. In addition, to meet any increased demand and take advantage of new business opportunities in the future, we may need to increase our workforce through additional employees or contract labor. Although we believe that increasing our workforce would potentially support anticipated growth and profitability, it would increase our costs. If we experience such an increase in costs, we may not succeed in achieving or sustaining profitability in the short term.

(17) The terms and conditions of our contracts could subject us to damages, losses and other expenses if we fail to meet delivery and other performance requirements.

Our service contracts typically include provisions imposing:

development, delivery and installation schedules;

customer acceptance and testing requirements; and

other performance requirements.

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To the extent these provisions involve performance over extended periods of time, risks of noncompliance may increase. From time to time we have experienced delays in system implementation, timely acceptance of

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programs, concerns regarding program performance and other contractual disputes. If we fail to meet contractual performance requirements as promised, or to successfully resolve customer disputes, we could incur liability for damages, as well as increased costs, lower margins, or compensatory obligations in addition to other losses, such as harm to our reputation. Any unexpected increases in costs to meet our contractual obligations or any other requirements necessary to address claims and damages with regard to our customer contracts could have a material adverse effect on our business and financial results.

(18) Products deploying our technology could have unknown defects or errors, which may give rise to claims against us, divert application of our resources from other purposes or increase our project implementation and support costs.

Products and services as complex as those we offer or develop may contain undetected defects or errors. Furthermore, we often provide complex implementation, integration, customization, consulting and other technical services in connection with the implementation and ongoing maintenance of our products. Despite testing, defects or errors in our products and services may occur, which could result in delays in the development and implementation of products and systems, inability to meet customer requirements or expectations in a timely manner, loss of revenue or market share, increased implementation and support costs, failure to achieve market acceptance, diversion of development resources, injury to our reputation, increased insurance costs, increased service and warranty costs and warranty or breach of contract claims. Although we attempt to reduce the risk of losses resulting from warranty or breach of contract claims through warranty disclaimers and liability limitation clauses in our sales agreements when we can, these contractual provisions are sometimes not included and may not be enforceable in every instance. If a court refuses to enforce the liability limiting provisions of our contracts for any reason, or if liabilities arise that were not contractually limited or adequately covered by insurance, the expense associated with defending these actions or paying the resultant claims could be significant.

(19) The security systems used in our product and service offerings may be circumvented or sabotaged by third parties, which could result in the disclosure of sensitive information or private personal information or cause other business interruptions that could damage our reputation and disrupt our business.

Our business relies on computers and other information technologies, both internal and at customer locations. The protective measures that we use may not prevent security breaches, and failure to prevent security breaches may disrupt our business, damage our reputation, and expose us to litigation and liability. A party who is able to circumvent security measures could misappropriate sensitive or proprietary information or materials or cause interruptions or otherwise damage our products, services and reputation, and the property of our customers. If unintended parties obtain sensitive data and information, or create bugs or viruses or otherwise sabotage the functionality of our systems, we may receive negative publicity, incur liability to our customers or lose the confidence of our customers, any of which may cause the termination or modification of our contracts. Further, our insurance coverage may be insufficient to cover losses and liabilities that may result from these events.

In addition, we may be required to expend significant capital and other resources to protect ourselves against the threat of security breaches or to alleviate problems caused by these breaches. Any protection or remedial measures may not be available at a reasonable price or at all, or may not be entirely effective if commenced.

(20) We are periodically involved in the ordinary course of business in litigation, and an adverse resolution of such litigation may adversely affect our business, financial condition, results of operations, and cash flows.

From time to time, in our normal course of business, we are a party to various legal claims, actions and complaints. For example, as part of our patent licensing program, we may bring claims or counterclaims of patent infringement to enforce our patent rights. Given the uncertain nature of litigation, we are not able to estimate the amount or range of gain or loss that could result from an outcome of litigation. Litigation can be expensive, lengthy, and disruptive to normal business operations. The results of complex legal proceedings are often

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uncertain and difficult to predict. We could incur costs in excess of any established accruals and, to the extent available, excess liability insurance. An unfavorable outcome in any legal proceedings could have a material adverse effect on our business, financial condition, results of operations, and cash flows.

RISKS RELATED TO OUR CAPITAL STOCK

(21) Our common stock price may be volatile, and you could lose all or part of your investment in shares of our common stock.

The price of shares of our common stock may fluctuate as a result of changes in our operating performance or prospects and other factors. Some specific factors that may have a significant effect on the price of shares of our common stock include:

the public's reaction to our public disclosures;

actual or anticipated changes in our operating results or future prospects;

potential unfavorable changes from originally reported royalties by customers resulting from an audit performed by us or a third party, or self-corrected by the customer;

strategic actions by us or our competitors, such as acquisitions or restructurings;

impact of acquisitions on our liquidity and financial performance;

new laws or regulations or new interpretations of existing laws or regulations applicable to our business;

changes in accounting standards, policies, guidance, interpretations or principles applicable to us;

conditions of the industry as a result of changes in financial markets or general economic or political conditions;

the failure of securities analysts to cover our common stock in the future, or changes in financial estimates by analysts;

changes in analyst recommendations or earnings estimates regarding us, other comparable companies or the industry generally, and our ability to meet those estimates;

changes in the amount of dividends paid, if any;

future issuances of our common stock or the perception that future sales could occur; and

volatility in the equity securities market.

(22) Our common stock price may increase or decrease on material news or developments.

As a thinly-traded microcap company, volatility in the equity securities market may disproportionately cause swings in our stock price, upward and downward, on positive and negative developments. We suspect that the effects of computerized trading also exacerbate fluctuations in our stock price.

(23) Our corporate governance documents, our rights agreement and Oregon law may delay or prevent an acquisition of us that shareholders may consider favorable, which could decrease the value of your shares.

Our articles of incorporation and bylaws and Oregon law contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. These provisions include supermajority voting requirements for shareholders to amend our organizational documents and limitations on actions by our shareholders by written consent. In addition, our board of directors has the right to issue preferred stock without shareholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. In July 2008, our Board of Directors adopted a rights agreement pursuant to which one one-hundredth

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(1/100) of a preferred stock purchase right will be issued for each outstanding share of our common stock. In general terms, our rights agreement works by imposing a significant penalty upon any person or group that acquires 15% or more of our outstanding common stock without the approval of our Board of Directors. Oregon law also restricts the ability to vote shares of stock acquired in a transaction that causes the acquiring person to control at least one-fifth, one-third or one-half of the votes entitled to be cast in the election of directors. Shares acquired in a control share acquisition have no voting rights except as authorized by a vote of the shareholders. Although we believe these provisions protect our shareholders from coercive or otherwise unfair takeover tactics and thereby provide for an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our board of directors, these provisions apply even if the offer may be considered beneficial by some shareholders.

ITEM 1B: UNRESOLVEDSTAFF COMMENTS

None.

ITEM 2: PROPERTIES

We lease our principal administrative, marketing, research, and intellectual property development facility, which is approximately 46,000 square feet in size and located in Beaverton, Oregon. In May 2010, we entered into an amendment with the landlord to extend the length of our facilities lease through August 2016.

In June 2013, we entered into a new facilities lease agreement in San Mateo, California, which is approximately 3,700 square feet in size, with a lease term through November 2016. In February 2015, we terminated this lease and entered into a facilities lease agreement for a different facility in San Mateo, California, which is approximately 5,400 square feet in size, with a lease term through March 2020.

See Note 9 of our Notes to Consolidated Financial Statements for further lease related disclosures.

ITEM 3: LEGALPROCEEDINGS

We are subject from time to time to legal proceedings and claims arising in the ordinary course of business.

Our wholly owned subsidiary, Contributor, was a defendant in a patent infringement lawsuit brought by Blue Spike, LLC (Blue Spike) (E.D. Texas, Civil Action No: 6:12-cv-540). The case was brought against Contributor in August 2012. We settled the lawsuit with Blue Spike, and pursuant to the settlement, were dismissed with prejudice from the case in October 2014. The total settlement amount was immaterial.

ITEM 4: MINESAFETY DISCLOSURES

Not applicable.

Table of Contents**PART II****ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock began trading on the Nasdaq Stock Market LLC in October 2008 under the symbol DMRC. The closing price of our common stock on the Nasdaq Global Market was \$27.75 on February 17, 2015. The following table lists the high and low sales prices of our common stock for the periods indicated, as reported by The Nasdaq Global Market.

	Year Ended December 31,			
	2014		2013	
	High	Low	High	Low
First quarter	\$ 36.93	\$ 18.97	\$ 26.79	\$ 20.72
Second quarter	\$ 37.00	\$ 28.78	\$ 26.00	\$ 19.05
Third quarter	\$ 34.91	\$ 19.90	\$ 22.46	\$ 18.86
Fourth quarter	\$ 31.36	\$ 20.04	\$ 22.72	\$ 17.85

At February 17, 2015, we had 227 shareholders of record of our common stock, as shown in the records of our transfer agent. Since many holders hold shares in street name, we believe that there is a significantly larger number of beneficial owners of our common stock than the number of record holders.

During the years ended December 31, 2014, 2013 and 2012, our Board of Directors declared and paid the following dividends per common share (in thousands, except per share data):

Declaration Date	Dividend Per Common Share	Record Date	Total Amount	Payment Date
April 23, 2014	\$ 0.11	May 5, 2014	\$ 830	May 12, 2014
February 20, 2014	\$ 0.11	March 3, 2014	\$ 824	March 10, 2014
October 22, 2013	\$ 0.11	November 4, 2013	\$ 802	November 12, 2013
July 25, 2013	\$ 0.11	August 5, 2013	\$ 799	August 12, 2013
April 30, 2013	\$ 0.11	May 13, 2013	\$ 800	May 20, 2013
February 20, 2013	\$ 0.11	March 4, 2013	\$ 801	March 11, 2013
October 23, 2012	\$ 0.11	November 6, 2012	\$ 783	November 20, 2012
July 26, 2012	\$ 0.11	August 10, 2012	\$ 782	August 24, 2012
April 26, 2012	\$ 0.11	May 11, 2012	\$ 779	May 25, 2012

In August 2014, we entered into an Equity Distribution Agreement, whereby we may sell from time to time through Wells Fargo Securities, LLC, as our sales agent, our common stock having an aggregate offering price of up to \$30 million. Wells Fargo Securities, LLC will receive from us a commission equal to 2.50% of the gross sales of common stock for shares having an aggregate offering price of up to \$10 million, and a commission of 2.25% of the gross sales of common stock thereafter, for shares sold under the Equity Distribution Agreement. For the year ended December 31, 2014, we sold 684,215 shares under this Equity Distribution Agreement totaling \$16.3 million of cash proceeds, net of commissions of \$0.4 million, and paid \$0.3 million in stock issuance costs.

In November 2011, our Board of Directors approved a stock repurchase program authorizing the purchase, at the discretion of management, of up to \$5.0 million of shares of our common stock for a one year period through periodic open-market or private transactions at then-prevailing market prices. In November 2013, the program was extended through December 31, 2014, at which point the program ended. As of December 31, 2014, we had repurchased 43,293 shares under the extended program at an aggregate purchase price of \$1.0 million.

In addition to the stock repurchase program described above, we withhold (repurchase) shares of common stock in connection with the vesting of restricted shares to satisfy required tax withholding obligations.

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The following table sets forth information regarding purchases of our equity securities during the three-month period ended December 31, 2014:

Period	(a) Total number of shares purchased (1)	(b) Average price paid per share (1)	(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
Month 1				
October 1, 2014 to October 31, 2014	900	\$ 24.81		\$ 4.0 million
Month 2				
November 1, 2014 to November 30, 2014	16,074	\$ 27.40		\$ 4.0 million
Month 3				
December 1, 2014 to December 31, 2014		\$		\$ 0.0 million
Total	16,974	\$ 27.26		

- (1) Fully vested shares of common stock withheld (purchased) by us in satisfaction of required withholding tax liability upon vesting of restricted stock.

Table of Contents**STOCK PERFORMANCE GRAPH**

The following graph compares the performance of our common stock with the performance of (i) the Nasdaq U.S. Index and (ii) a peer group selected by us. The comparison assumes \$100 was invested in our common stock on December 31, 2009 and in each of the two indices at the closing price on that date, and assumes reinvestment of any dividends. We believe that the companies in the peer group are comparable to us in terms of line-of-business, market capitalization, revenue, and number of employees, and therefore, comprise an appropriate peer group for purposes of comparing stock performance. The comparisons in the graph are based on historical data and are not indicative of, nor intended to forecast, future performance of our common stock.

Companies included in the Peer Group index of the stock performance graph are as follows:

8X8 INC	DTS INC	ORBCOMM INC
AWARE INC	eGain CORPORATION	PDF SOLUTIONS INC
BRIGHTCOVE INC	EVOLVING SYSTEMS INC	SPARK NETWORKS INC
CALLIDUS SOFTWARE INC	GLU MOBILE INC	SUPPORT.COM INC
CINEDIGM CORP	GUIDANCE SOFTWARE	TOWERSTREAM CORPORATION
DATAWATCH CORPORATION	IMMERSION CORPORATION	ZIX CORPORATION

ITEM 6: SELECTED FINANCIAL DATA

The selected financial data set forth below should be read in conjunction with the consolidated financial statements and the notes to the consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations, which are included elsewhere in this report.

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The following tables set forth our selected financial information as of and for each of the years in the five-year period ended December 31, 2014, which has been derived from audited financial statements as of December 31, 2014, 2013, 2012, 2011 and 2010 and for the years ended December 31, 2014, 2013, 2012, 2011 and 2010.

Statement of Operations Data

	Year Ended December 31,				
	2014	2013	2012	2011	2010
Revenue	\$ 25,658	\$ 34,964	\$ 44,375	\$ 36,039	\$ 31,150
Gross profit percentage	67%	77%	85%	81%	78%
Operating income (loss)	\$ (15,223)	\$ (2,412)	\$ 14,594	\$ 6,389	\$ 6,151
Net income (loss)	\$ (15,820)	\$ (507)	\$ 8,272	\$ 5,656	\$ 4,174
Earnings (loss) per common share:					
Earnings (loss) per common share basic	\$ (2.22)	\$ (0.10)	\$ 1.16	\$ 0.84	\$ 0.59
Earnings (loss) per common share diluted	\$ (2.22)	\$ (0.10)	\$ 1.12	\$ 0.76	\$ 0.55
Weighted average common shares outstanding basic (in thousands)	7,187	6,866	6,757	6,741	7,120
Weighted average common shares outstanding diluted (in thousands)	7,187	6,866	6,989	7,430	7,623
Cash dividends declared per common share	\$ 0.22	\$ 0.44	\$ 0.33	\$	\$

Balance Sheet Data

	As of December 31,				
	2014	2013	2012	2011	2010
Cash, cash equivalents and short-term marketable securities	\$ 38,323	\$ 29,662	\$ 32,269	\$ 25,663	\$ 34,781
Long-term marketable securities	\$ 749	\$ 5,302	\$ 6,787	\$ 7,715	\$ 11,163
Total assets	\$ 57,416	\$ 57,197	\$ 57,331	\$ 45,793	\$ 55,765
Long-term liabilities	\$ 203	\$ 496	\$ 673	\$ 464	\$ 525
Redeemable preferred stock	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50

ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements relating to future events or the future financial performance of Digimarc, which involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements. Please see the discussion regarding forward-looking statements included at the end of this discussion, under the caption "Forward-Looking Statements" and Item 1A, "Risk Factors" for a discussion of some of the uncertainties, risks and assumptions associated with these statements.

The following discussion should be read in conjunction with our consolidated financial statements and the related notes and other financial information appearing elsewhere in this Annual Report on Form 10-K.

All dollar amounts are in thousands except per share amounts or unless otherwise noted. Percentages within the following tables included in this section may not foot due to rounding.

Overview

Digimarc Corporation enables governments and enterprises around the world to give digital identities to media and objects that computers and digital devices can sense and recognize and to which they can react. We

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have developed an Intuitive Computing Platform that is intended to optimize the identification of consumer brand impressions, facilitating modern mobile-centric shopping. The Platform includes the means to infuse persistent digital information, Digimarc IDs, perceptible only to computers and digital devices, into all forms of media content, including consumer products packaging. Digimarc IDs for packaging, often referred to as Digimarc Barcodes, facilitate remarkably faster scanning of items at retail checkout as well as improved interaction with consumers. The unique digital identifier placed in media generally persists with it regardless of the distribution path and whether it is copied, manipulated or converted to a different format, and does not affect the quality of the content or the enjoyment or other traditional uses of it. Our technology permits computers and digital devices to quickly identify relevant data from vast amounts of media content.

Our growth strategy encompasses both our government and commercial businesses. We plan to continue investing in research and development and sales and marketing to develop and market our products including Digimarc Discover, Digimarc Barcode and Digimarc Guardian and continue to expand our intellectual property portfolio.

To protect our significant efforts in creating our technology, we have implemented an extensive intellectual property protection program that relies on a combination of patent, copyright, trademark and trade secret laws, and nondisclosure agreements and other contracts. As a result, we believe we have one of the world's most extensive patent portfolios in the field of digital watermarking and related fields, with greater than 1,200 U.S. and foreign patents and pending patent applications as of December 31, 2014. We continue to develop and broaden our portfolio of patented technology in the fields of media identification and management technology and related applications and systems. We devote significant resources to developing and protecting our inventions and continuously seek to identify and evaluate potential licensees for our patents.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP) requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to bad debts, contingencies, goodwill, income taxes, intangible assets, marketable securities, property and equipment and revenue recognition. We base our estimates on historical experience and on other assumptions we believe to be reasonable in the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Some of our accounting policies require higher degrees of judgment than others in their application. These include revenue recognition, goodwill, impairment of long-lived assets, contingencies and income taxes. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition: We account for customer arrangements that encompass multiple deliverables, such as patent licenses, professional services, software licenses, and maintenance and support fees, under ASC 605-25 *Multiple-Element Arrangements*. For arrangements that include multiple deliverables, we identify and divide the deliverables into separate units of accounting at inception if certain criteria are met. We apply ASC 985 to software deliverables when relevant. The consideration for the arrangements under ASC 605-25 is allocated to the separate units of accounting using the relative selling price method.

The relative selling price method allocates the consideration based on our specific assumptions rather than assumptions of a marketplace participant, and any discount in the arrangement proportionally to each deliverable on the basis of each deliverable's selling price.

Applicable revenue recognition criteria are considered separately for each separate unit of accounting as follows:

Service revenue is generally determined based on time and materials. Revenue for professional services is recognized as the services are performed. Billing for services rendered generally occurs within one month after the services are provided.

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Subscription revenue, which includes subscriptions for products and services, is generally paid in advance and recognized over the term of the subscription, which is generally one month to twenty-four months.

License revenue is recognized when amounts owed to Digimarc have been earned, are fixed or determinable (within our normal 30 to 60 day payment terms), and collection is reasonably assured. If the payment terms extend beyond our normal 30 to 60 days, the fee may not be considered to be fixed or determinable, and the revenue would then be recognized when installments are due.

We record revenue from certain license agreements upon cash receipt as a result of collectability not being reasonably assured.

Our standard payment terms for license arrangements are 30 to 60 days. Extended payment terms on patent license arrangements are not considered to be fixed or determinable if payments are due beyond our standard payment terms, primarily because of the risk of substantial modification present in our patent licensing business. As such, revenue on license arrangements with extended payment terms are recognized as fees become fixed or determinable.

Goodwill: We account for business combinations under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, where the total purchase price is allocated to the tangible and identified intangible assets acquired and liabilities assumed based on their estimated fair values. The purchase price is allocated using the information currently available, and may be adjusted, up to one year from acquisition date, after obtaining more information regarding, among other things, asset valuations, liabilities assumed and revisions to preliminary estimates.

Contingent consideration, if any, is recorded at the acquisition date based upon the estimated fair value of the contingent payments. The fair value of the contingent consideration is re-measured each reporting period with any adjustments in fair value being recognized in earnings from operations.

The purchase price in excess of the fair value of the tangible and identified intangible assets acquired less liabilities assumed is recognized as goodwill.

We test goodwill for impairment annually in June and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Such reviews assess the fair value of our assets compared to their carrying value. We operate as a single reporting unit. We estimate the fair value of our single reporting unit using a market approach, which takes into account our market capitalization plus an estimated control premium.

In connection with our annual impairment test of goodwill as of June 30, 2014 and 2013, we concluded that there was no impairment as the estimated fair value of our single reporting unit substantially exceeded the carrying value.

Impairment of long-lived assets: We assess long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, in accordance with the provisions of ASC 360 *Property, Plant and Equipment*. Conditions that could trigger a long-lived asset impairment assessment include, but are not limited to, a significant decrease in the market price of a long-lived asset, a significant adverse change in legal factors or in the business climate that could affect the value of an asset, or a current-period operating or cash flow loss combined with a history of operating or cash flow losses.

Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the assets to future net undiscounted cash flows expected to be generated by the assets over their remaining useful life. If such assets are considered to be impaired, the impairment would be recognized in operating results at the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value is determined based on discounted cash flows or appraised values, depending on the nature of the assets.

Considerable management judgment is required in determining if and when a condition would trigger an impairment assessment of our long-lived assets and once such a determination has been made, considerable

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management judgment is required to determine the expected net undiscounted future cash flows to be generated by the assets over their remaining useful life and, if necessary, the fair market value of those assets.

We concluded a triggering event occurred during the fourth quarter of 2014, due to operating losses in 2013 and 2014 and a projected operating loss in 2015, and we tested our long-lived assets for impairment as of December 31, 2014. Our assessment compared the net undiscounted future cash flows that each asset group is projected to generate to the carrying value of each asset group. Key assumptions used in our impairment test included future sales of our products and services, renewal rates of existing contracts and future levels of expenses. Our analysis of projected net undiscounted future cash flows significantly exceeded the book value for these asset groups. Accordingly, we did not record any impairment charge during the year ended December 31, 2014.

Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Contingencies: We evaluate all pending or threatened contingencies or commitments, if any, that are reasonably likely to have a material adverse effect on our operations or financial position. We assess the probability of an adverse outcome and determine if it is remote, reasonably possible or probable as defined in accordance with the provisions of ASC 450 *Contingencies*. If information available prior to the issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of our financial statements, and the amount of the loss, or the range of probable loss can be reasonably estimated, then the loss is accrued and charged to operations. If no accrual is made for a loss contingency because one or both of the conditions pursuant to ASC 450 are not met, but the probability of an adverse outcome is at least reasonably possible, we will disclose the nature of the contingency and provide an estimate of the possible loss or range of loss, or state that such an estimate cannot be made.

Income taxes: We record valuation allowances on our deferred tax assets if, based on available evidence, it is more-likely-than-not that all or some portion of the assets will not be realized. The determination of whether our deferred tax assets are realizable requires management to identify and weight all available positive and negative evidence. Management considers recent financial performance, projected future taxable income, scheduled reversals of deferred tax liabilities, tax planning strategies and other evidence in assessing the realizability of our deferred tax assets.

We recorded a \$6.8 million non-cash income tax charge during the fourth quarter of 2014 to record a full valuation allowance against our deferred tax assets largely due to the cumulative loss we have incurred over the last three years, which is considered a significant piece of negative evidence when assessing the realizability of deferred tax assets.

We are subject to federal and state income taxes within the U.S., and, in the ordinary course of business, there are transactions and calculations where the ultimate tax determination is uncertain. We report a liability (or contra asset) for unrecognized tax benefits resulting from uncertain tax positions taken (or expected to be taken) on a tax return. We recognize interest and penalties, if any, related to the unrecognized tax benefits in income tax expense.

Table of Contents**Results of Operations the Years Ended December 31, 2014 and December 31, 2013**

The following tables present our consolidated statements of operations data for the periods indicated.

	Year Ended December 31, 2014	Year Ended December 31, 2013
Revenue:		
Service	\$ 11,727	\$ 11,631
Subscription	6,203	5,591
License	7,728	17,742
Total revenue	25,658	34,964
Cost of revenue:		
Service	5,077	5,327
Subscription	3,020	2,491
License	334	387
Total cost of revenue	8,431	8,205
Gross profit	17,227	26,759
Operating expenses:		
Sales and marketing	7,974	6,144
Research, development and engineering	13,711	12,274
General and administrative	8,972	9,624
Intellectual property	1,793	1,129
Total operating expenses	32,450	29,171
Operating loss	(15,223)	(2,412)
Other income, net	55	109
Loss before income taxes	(15,168)	(2,303)
(Provision) benefit for income taxes	(652)	1,796
Net loss	\$ (15,820)	\$ (507)

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	Year Ended December 31, 2014	Year Ended December 31, 2013
Percentages are percent of revenue		
Revenue:		
Service	46%	33%
Subscription	24	16
License	30	51
Total revenue	100	100
Cost of revenue:		
Service	20	15
Subscription	12	7
License	1	1
Total cost of revenue	33	23
Gross profit	67	77
Operating expenses:		
Sales and marketing	31	18
Research, development and engineering	53	35
General and administrative	35	27
Intellectual property	7	3
Total operating expenses	126	83
Operating loss	(59)	(7)
Other income, net		
Loss before income taxes	(59)	(7)
(Provision) benefit for income taxes	(3)	5
Net loss	(62)%	(1)%

Summary

In 2013, we increased the level of our investments in our product development and sales growth initiatives, primarily through hiring additional engineering and sales personnel. These initiatives included developing and marketing Digimarc Discover, Digimarc Barcode and other aspects of our Intuitive Computing Platform as well as further developing our retained patent assets and exploring strategic opportunities in the mobile payments market. In 2014, we continued these investments and made additional investments to expand our sales organization and expand the Digimarc Guardian product offering.

Total revenue decreased 27% to \$25.7 million in 2014 from \$35.0 million in 2013 primarily due to the scheduled completion of the quarterly license fee payments from Intellectual Ventures (IV) in the second quarter of 2013 and from The Nielsen Company (Nielsen) in the first quarter of 2014.

Total operating expenses increased 11% to \$32.5 million from \$29.2 million in 2013 primarily reflecting the full-year impact of the continued investments in our product development and sales growth initiatives.

Table of Contents**Revenue**

	Year Ended December 31, 2014	Year Ended December 31, 2013	Dollar Increase (Decrease)	Percent Increase (Decrease)
Revenue:				
Service	\$ 11,727	\$ 11,631	\$ 96	1%
Subscription	6,203	5,591	612	11%
License	7,728	17,742	(10,014)	(56)%
Total	\$ 25,658	\$ 34,964	\$ (9,306)	(27)%
Revenue (as % of total revenue):				
Service	46%	33%		
Subscription	24%	16%		
License	30%	51%		
Total	100%	100%		

Service. Service revenue consists primarily of software development and consulting services. The majority of service revenue arrangements are structured as time and materials consulting agreements. Most of our service revenue is derived from contracts with the Central Banks, IV and government agency contractors. The agreements range from several months to several years in length, and our longer term contracts are subject to work plans that are reviewed and agreed upon at least annually. These contracts generally provide for billing hours worked at predetermined rates and, to a lesser extent, reimbursement for third party costs and services. Increases or decreases in the services provided under these contracts are generally subject to both volume and price changes. The volume of work is generally negotiated at least annually and can be modified as the customer's needs change. We also have provisions in our longer term contracts that allow for specific hourly rate price increases on an annual basis to account for cost of living variables. Contracts with government agency contractors are generally shorter term in nature, less linear in billings and less predictable than our longer term contracts because the contracts with government agency contractors are subject to government budgets and funding.

The increase in service revenue was due primarily to higher billing rates under our contract with the Central Banks, partially offset by lower revenue due to timing of work with a government agency contractor.

Subscription. Subscription revenue includes subscriptions for products and services, is generally recurring in nature, paid in advance and recognized over the term of the subscription.

The increase in subscription revenue was due primarily to higher sales of our Digimarc Discover and Guardian products.

License. License revenue originates primarily from licensing our technology and patents where we receive fixed license fees and/or royalties as our income stream. The majority of our 2014 license revenue was derived from contracts with Verance Corporation (Verance), Civolution and Nielsen. Revenue from our licensed products have minimal associated direct costs, and thus are highly profitable.

The decrease in license revenue was due primarily to the scheduled completion of the quarterly license fee payments from IV in the second quarter of 2013 and from Nielsen in the first quarter of 2014 and lower reported quarterly royalties from other licensees, partially offset by a \$1.0 million license fee payment from Verance in the third quarter of 2014 to extend an existing license through 2023 in effect waiving any future royalties and license fees.

Table of Contents**Revenue by geography**

	Year Ended December 31, 2014	Year Ended December 31, 2013	Dollar Decrease	Percent Decrease
Revenue by geography:				
Domestic	\$ 9,596	\$ 18,857	\$ (9,261)	(49)%
International	16,062	16,107	(45)	(0)%
Total	\$ 25,658	\$ 34,964	\$ (9,306)	(27)%
Revenue (as % of total revenue):				
Domestic	37%	54%		
International	63%	46%		
Total	100%	100%		

The decrease in domestic revenue was primarily the result of the scheduled completion of the quarterly license fee payments from IV and Nielsen in the second quarter of 2013 and first quarter of 2014, respectively.

The decrease in international revenue was primarily due to lower reported quarterly royalties from an international licensee, partially offset by higher billing rates under our contract with the Central Banks.

We anticipate revenue in 2015 will be reasonably consistent with 2014 reflecting the end of license payments from Verance and Nielsen, offset by growth in revenues from our Digimarc Discover, Barcode and Guardian products and higher service revenue.

Cost of revenue

Service. Cost of service revenue primarily includes costs that are allocated from research, development and engineering, sales and marketing and intellectual property that relate directly to performing services under our customer contracts and direct costs of program delivery for both personnel and operating expenses. Costs include:

compensation, benefits, incentive compensation in the form of stock-based compensation and related costs of our software developers, quality assurance personnel, product managers, business development managers and other personnel where we bill our customers for time and materials costs;

payments to outside contractors that are billed to customers;

charges for equipment directly used by customers;

depreciation and other charges for machinery, equipment and software directly used by customers;

travel costs directly attributable to service and development contracts; and

charges for infrastructure and centralized costs of facilities and information technology.

Subscription. Cost of subscription revenue primarily includes:

compensation, benefits, incentive compensation in the form of stock-based compensation and related costs of operations personnel and the cost of contractors to support our Digimarc Guardian subscription service;

amortization of existing technology acquired in the Contributor acquisition;

Internet service provider connectivity charges and image search data fees to support the services offered to our subscription customers; and

charges for infrastructure and centralized costs of facilities and information technology.

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License. Cost of license revenue primarily includes:

amortization of capitalized patent costs and patent maintenance fees;

license costs for any software and/or patents licensed from third parties; and

charges for infrastructure and centralized costs of facilities and information technology.

Gross profit

	Year Ended December 31, 2014	Year Ended December 31, 2013	Dollar Increase (Decrease)	Percent Increase (Decrease)
Gross Profit:				
Service	\$ 6,650	\$ 6,304	\$ 346	5%
Subscription	3,183	3,100	83	3%
License	7,394	17,355	(9,961)	(57)%
Total	\$ 17,227	\$ 26,759	\$ (9,532)	(36)%