

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

Or

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

For the transition period _____ to _____

Commission file number: 001-33660

**ClearOne.
CLEARONE, INC.**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

87-0398877

(I.R.S. employer identification number)

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

(Address of principal executive offices)

84116

(Zip Code)

+1 (801) 975-7200

(Registrant's telephone number, including area code)

Indicate by check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Larger Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of ClearOne common stock outstanding as of November 6, 2018 was 8,306,535.

CLEARONE, INC.
QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2018

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PART I - FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CLEARONE, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except par value)

| | September 30, 2018 | December 31, 2017 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 2,522 | \$ 5,571 |
| Marketable securities | 1,972 | 2,689 |
| Receivables, net of allowance for doubtful accounts of \$580 and \$472, respectively | 5,212 | 7,794 |
| Inventories, net | 13,299 | 14,415 |
| Distributor channel inventories | — | 1,555 |
| Prepaid expenses and other assets | 2,525 | 1,862 |
| Total current assets | 25,530 | 33,886 |
| Long-term marketable securities | 5,757 | 10,349 |
| Long-term inventories, net | 8,266 | 8,708 |
| Property and equipment, net | 1,451 | 1,549 |
| Intangibles, net | 9,418 | 6,543 |
| Deferred income taxes | — | 6,531 |
| Other assets | 377 | 311 |
| Total assets | \$ 50,799 | \$ 67,877 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 3,364 | \$ 4,122 |
| Accrued liabilities | 1,668 | 1,843 |
| Deferred product revenue | 250 | 4,635 |
| Total current liabilities | 5,282 | 10,600 |
| Deferred rent | 135 | 103 |
| Other long-term liabilities | 646 | 607 |
| Total liabilities | 6,063 | 11,310 |
| Shareholders' equity: | | |
| Common stock, par value \$0.001, 50,000,000 shares authorized, 8,306,535 and 8,319,022 shares issued and outstanding | 8 | 8 |
| Additional paid-in capital | 47,875 | 47,464 |
| Accumulated other comprehensive loss | (208) | (65) |
| Retained earnings (deficit) | (2,939) | 9,160 |
| Total shareholders' equity | 44,736 | 56,567 |
| Total liabilities and shareholders' equity | \$ 50,799 | \$ 67,877 |

See accompanying notes

**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE LOSS**

(Dollars in thousands, except per share amounts)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue | \$ 6,683 | \$ 10,560 | \$ 20,943 | \$ 32,549 |
| Cost of goods sold | 3,703 | 4,051 | 10,614 | 13,293 |
| Gross profit | 2,980 | 6,509 | 10,329 | 19,256 |
| Operating expenses: | | | | |
| Sales and marketing | 2,168 | 3,006 | 7,796 | 8,393 |
| Research and product development | 1,781 | 2,268 | 5,757 | 6,947 |
| General and administrative | 1,341 | 1,281 | 4,500 | 5,597 |
| Impairment of intangibles | — | 736 | — | 736 |
| Impairment of goodwill | — | 12,724 | — | 12,724 |
| Total operating expenses | 5,290 | 20,015 | 18,053 | 34,397 |
| Operating loss | (2,310) | (13,506) | (7,724) | (15,141) |
| Other income, net | 5 | 78 | 78 | 264 |
| Loss before income taxes | (2,305) | (13,428) | (7,646) | (14,877) |
| Provision for (benefit from) income taxes | 7,837 | (4,152) | 6,505 | (4,313) |
| Net loss | \$ (10,142) | \$ (9,276) | \$ (14,151) | \$ (10,564) |
| Basic weighted average shares outstanding | 8,306,707 | 8,520,041 | 8,304,974 | 8,641,173 |
| Diluted weighted average shares outstanding | 8,306,707 | 8,520,041 | 8,304,974 | 8,641,173 |
| Basic loss per share | \$ (1.22) | \$ (1.09) | \$ (1.70) | \$ (1.22) |
| Diluted loss per share | \$ (1.22) | \$ (1.09) | \$ (1.70) | \$ (1.22) |
| Comprehensive loss: | | | | |
| Net loss | \$ (10,142) | \$ (9,276) | \$ (14,151) | \$ (10,564) |
| Unrealized gain (loss) on available-for-sale securities, net of tax | (22) | 10 | (93) | 68 |
| Change in foreign currency translation adjustment | (13) | 23 | (51) | 88 |
| Comprehensive loss | \$ (10,177) | \$ (9,243) | \$ (14,295) | \$ (10,408) |

See accompanying notes

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands, except per share amounts)

| | Nine months ended September 30, | |
|---|---------------------------------|-----------------|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net loss | \$ (14,151) | \$ (10,564) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization expense | 1,169 | 1,172 |
| Impairment of goodwill and intangible assets | — | 13,460 |
| Amortization of deferred rent | (29) | (53) |
| Stock-based compensation expense | 379 | 514 |
| Provision for doubtful accounts, net | 112 | 106 |
| Change of inventory to net realizable value | 471 | — |
| Loss on disposal of assets | — | 1 |
| Deferred income taxes | 6,531 | (5,221) |
| Changes in operating assets and liabilities: | | |
| Receivables | 2,458 | (649) |
| Inventories | 1,087 | (8,964) |
| Prepaid expenses and other assets | (369) | (226) |
| Accounts payable | (758) | 2,257 |
| Accrued liabilities | (112) | (67) |
| Income taxes payable | (364) | 699 |
| Deferred product revenue | (44) | (23) |
| Other long-term liabilities | 39 | (61) |
| Net cash used in operating activities | <u>(3,581)</u> | <u>(7,619)</u> |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (281) | (537) |
| Purchase of intangibles | (94) | (203) |
| Capitalized patent defense costs | (3,573) | (845) |
| Proceeds from maturities and sales of marketable securities | 7,502 | 9,946 |
| Purchases of marketable securities | (2,284) | (3,915) |
| Net cash provided by investing activities | <u>1,270</u> | <u>4,446</u> |
| Cash flows from financing activities: | | |
| Net proceeds from equity-based compensation programs | 32 | 117 |
| Dividend payments | (583) | (1,650) |
| Repurchase and cancellation of stock options | — | (285) |
| Repurchase and cancellation of stock | (147) | (4,151) |
| Net cash used in financing activities | <u>(698)</u> | <u>(5,969)</u> |
| Effect of exchange rate changes on cash and cash equivalents | <u>(40)</u> | <u>55</u> |
| Net decrease in cash and cash equivalents | (3,049) | (9,087) |
| Cash and cash equivalents at the beginning of the period | 5,571 | 12,100 |
| Cash and cash equivalents at the end of the period | <u>\$ 2,522</u> | <u>\$ 3,013</u> |

See accompanying notes

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands, except per share amounts)

The following is a summary of supplemental cash flow activities:

| | Nine months ended September 30, | |
|----------------------------|---------------------------------|------|
| | 2018 | 2017 |
| Cash paid for income taxes | \$ 11 | \$ 6 |

See accompanying notes

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

1. Business Description, Basis of Presentation and Significant Accounting Policies

Business Description:

ClearOne, Inc., together with its subsidiaries (collectively, “ClearOne” or the “Company”), is a global market leader enabling conferencing, collaboration, and network streaming solutions. The performance and simplicity of our advanced, comprehensive solutions offer unprecedented levels of functionality, reliability and scalability.

Basis of Presentation:

The fiscal year for ClearOne is the 12 months ending on December 31. The consolidated financial statements include the accounts of ClearOne and its subsidiaries. All significant inter-company accounts and transactions have been eliminated.

These accompanying interim unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and are not audited. Certain information and footnote disclosures that are usually included in financial statements prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) have been either condensed or omitted in accordance with SEC rules and regulations. The accompanying condensed consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of our financial position as of September 30, 2018 and December 31, 2017, the results of operations for the three and nine months ended September 30, 2018 and 2017, and the cash flows for the nine months ended September 30, 2018 and 2017. The results of operations for the three and nine months ended September 30, 2018 and 2017 are not necessarily indicative of the results for a full-year period. These interim unaudited condensed consolidated financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC.

Significant Accounting Policies:

The significant accounting policies were described in Note 1 to the audited consolidated financial statements included in the Company’s annual report on Form 10-K for the year ended December 31, 2017. There have been no changes to these policies during the nine months ended September 30, 2018 that are of significance or potential significance to the Company except for the change in revenue recognition policy described below.

Adoption of New Revenue Standard: On January 1, 2018, as required, the Company adopted ASU No. 2014-09 - Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”), ASU No. 2015-14 - Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date (“ASU 2015-14”), ASU No. 2016-08 - Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (“ASU 2016-08”), ASU No. 2016-10 - Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing (“ASU 2016-10”), ASU No. 2016-12 - Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients (“ASU 2016-12”) and ASU No. 2016-20 - Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers (“ASU 2016-20”) (collectively “the New Revenue Standard”). To conform to the New Revenue Standard, the Company modified its revenue recognition policy as described further below.

Change in Accounting Policy: On January 1, 2018, the Company adopted the New Revenue Standard using the modified retrospective method, applying the guidance to all open contracts and recognized an adjustment to increase retained earnings by \$2,783, reduce deferred product revenue by \$4,338 and reduce distributor channel inventories by \$1,555 as of that date. The comparative financial information has not been restated and continues to be presented under the accounting standards in effect for the respective periods. The Company applied the practical expedient and has not disclosed the revenue allocated to future shipments of partially completed contracts.

Prior to our change in accounting policy, revenue from product sales to distributors was not recognized until the return privilege had expired or until it can be determined with reasonable certainty that the return privilege had expired, which approximated when the product was sold-through to customers of our distributors (dealers, system integrators, value-added resellers, and end-users), rather than when the product was initially shipped to a distributor. At each quarter-end, we evaluated the inventory in the distribution channel through information provided by our distributors. The level of inventory in the channel fluctuated up or down each quarter based upon our distributors’ individual operations. Accordingly, each quarter-end deferral of revenue and associated cost of goods sold were calculated and recorded based upon the actual channel inventory reported at quarter-end. Further, with respect to distributors and other channel partners not reporting the channel inventory, the revenue and associated cost of goods sold were deferred until we received payment for the product sales made to such distributors or channel partners.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

After the change in the accounting policy, substantially all of the Company's revenue is recognized following the transfer of control of the products to the customer, which typically occurs upon shipment or delivery depending on the terms of the underlying contracts. During the three and nine months ended September 30, 2018, revenue decreased by \$784 and \$1,365, respectively due to the impact of the adoption of the New Revenue Standard.

Revenue Recognition Policy: The Company generates revenue from sales of its audio and video conferencing equipment to distributors, system integrators and value-added resellers. The Company also generates revenue, to a much lesser extent, from sale of software and licenses to distributors, system integrators, value-added resellers and end-users. The Company recognizes revenue when it satisfies a performance obligation in an amount reflecting the consideration to which it expects to be entitled. For sales agreements, the Company has identified the promise to transfer products, each of which are distinct, to be the performance obligation. The Company applies a five-step approach in determining the amount and timing of revenue to be recognized: (1) identifying the contract with a customer, (2) identifying the performance obligations in the contract, (3) determining the transaction price, (4) allocating the transaction price to the performance obligations in the contract and (5) recognizing revenue when the performance obligation is satisfied. Substantially all of the Company's revenue is recognized at the time control of the products transfers to the customer.

Sales agreements with customers are renewable periodically and contain terms and conditions with respect to payment, delivery, warranty and supply, but typically do not require mandatory purchase commitments. In the absence of a sales agreement, the Company's standard terms and conditions at the time of acceptance of purchase orders apply. The Company considers the customer purchase orders, governed by sales agreements or the Company's standard terms and conditions, to be the contract with the customer. The Company evaluates certain factors including the customer's ability to pay (or credit risk).

In determining the transaction price, the Company evaluates whether the price is subject to refund or adjustment to determine the net consideration to which the Company expects to be entitled. Sales to distributors, are typically made pursuant to agreements that provide return rights with respect to discontinued or slow-moving products, referred to as stock rotation. Sales to distributors can also be subject to price adjustment on certain products, primarily for distributors with drop-shipping rights. Although payment terms vary, most distributor agreements require payment within 45 days of invoicing.

The Company recognizes revenue when it satisfies a performance obligation. The Company recognizes revenue from sales agreements upon transferring control of a product to the customer. This typically occurs when products are shipped or delivered, depending on the delivery terms, or when products that are consigned at customer locations are sold to dealers or end users. Revenue recognized during the three and nine months ended September 30, 2018 for equipment sales was \$6,524 and \$20,396, respectively and for software, licenses, etc. was \$159 and \$547, respectively. Sales returns and allowances are estimated based on historical experience. Provisions for discounts and rebates to customers, estimated returns and allowances, ship and credit claims and other adjustments are provided for in the same period the related revenues are recognized, and are netted against revenues. For returns, the Company recognizes a related asset for the right to recover returned products with a corresponding reduction to cost of goods sold. The Company reviews warranty and related claims activity and records provisions, as necessary.

Frequently, the Company receives orders with multiple delivery dates that may extend across reporting periods. Since each delivery constitutes a performance obligation, the Company allocates the transaction price of the contract to each performance obligation based on the stand-alone selling price of the products. The Company invoices the customer for each delivery upon shipment and recognizes revenues in accordance with delivery terms. Although payment terms vary, distributors typically pay within 45 days of invoicing and dealers pay within 30 days of invoicing. As scheduled delivery dates are within one year, revenue allocated to future shipments of partially completed contracts are not disclosed.

The Company has elected to record freight and handling costs associated with outbound freight after control over a product has transferred to a customer as a fulfillment cost and include it in cost of revenues. Taxes assessed by government authorities on revenue-producing transactions, including value-added and excise taxes, are presented on a net basis (excluded from revenues) in the Consolidated Statements of Operations and Comprehensive Income.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

Recent Accounting Pronouncements:

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

In August 2016, the FASB released ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments, which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. ASU 2016-15 became effective for the Company on January 1, 2018. ASU 2016-15 had no material impact on our consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting. The new guidance provides clarity and reduces both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation-Stock Compensation, to a change to the terms or conditions of a share-based payment award. The accounting standard update became effective for the Company on January 1, 2018. ASU 2017-09 did not have any material impact on our consolidated financial statements.

2. Revenue Information

The following table disaggregates the Company's revenue into primary product groups:

| | Three months ended September 30, 2018 | Nine months ended September 30, 2018 |
|-----------------------------------|--|---|
| Professional audio products | \$ 4,781 | \$ 14,586 |
| Unified Communications end points | 776 | 2,789 |
| Video products | 1,126 | 3,568 |
| | <u>\$ 6,683</u> | <u>\$ 20,943</u> |

The following table disaggregates the Company's revenue into major regions:

| | Three months ended September 30, 2018 | Nine months ended September 30, 2018 |
|--|--|---|
| North and South America | \$ 4,082 | \$ 12,538 |
| Asia (including Middle East) and Australia | 1,693 | 5,592 |
| Europe and Africa | 908 | 2,813 |
| | <u>\$ 6,683</u> | <u>\$ 20,943</u> |

3. Earnings (Loss) Per Share

Earnings (loss) per common share is computed based on the weighted-average number of common shares outstanding and, when appropriate, dilutive potential common stock outstanding during the period. Stock options are considered to be potential common stock. The computation of diluted earnings (loss) per share does not assume exercise or conversion of securities that would have an anti-dilutive effect.

Basic earnings (loss) per common share is the amount of net earnings (loss) for the period available to each weighted-average share of common stock outstanding during the reporting period. Diluted earnings (loss) per common share is the amount of earnings (loss) for the period available to each weighted-average share of common stock outstanding during the reporting period and to each share of potential common stock outstanding during the period, unless inclusion of potential common stock would have an anti-dilutive effect.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

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

| | <u>Three months ended September 30,</u> | | <u>Nine months ended September 30,</u> | |
|---|---|------------------|--|------------------|
| | <u>2018</u> | <u>2017</u> | <u>2018</u> | <u>2017</u> |
| Numerator: | | | | |
| Net loss | \$ (10,142) | \$ (9,276) | \$ (14,151) | \$ (10,564) |
| Denominator: | | | | |
| Basic weighted average shares outstanding | 8,306,707 | 8,520,041 | 8,304,974 | 8,641,173 |
| Dilutive common stock equivalents using treasury stock method | — | — | — | — |
| Diluted weighted average shares outstanding | <u>8,306,707</u> | <u>8,520,041</u> | <u>8,304,974</u> | <u>8,641,173</u> |
| Basic loss per common share | \$ (1.22) | \$ (1.09) | \$ (1.70) | \$ (1.22) |
| Diluted loss per common share | \$ (1.22) | \$ (1.09) | \$ (1.70) | \$ (1.22) |
| Weighted average options outstanding | 711,888 | 782,012 | 727,980 | 832,953 |
| Anti-dilutive options not included in the computations | 711,888 | 782,012 | 727,980 | 832,953 |

4. Marketable Securities

The Company has classified its marketable securities as available-for-sale securities. These securities are carried at estimated fair value with unrealized holding gains and losses included in accumulated other comprehensive income (loss) in stockholders' equity until realized. Gains and losses on marketable security transactions are reported on the specific-identification method. Dividend and interest income are recognized when earned.

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value for available-for-sale securities by major security type and class of securities at September 30, 2018 and December 31, 2017 were as follows:

| | <u>Amortized cost</u> | <u>Gross unrealized holding gains</u> | <u>Gross unrealized holding losses</u> | <u>Estimated fair value</u> |
|-------------------------------------|---------------------------|---|--|---------------------------------|
| September 30, 2018 | | | | |
| Available-for-sale securities: | | | | |
| Corporate bonds and notes | \$ 4,055 | \$ — | \$ (49) | \$ 4,006 |
| Municipal bonds | 3,775 | — | (52) | 3,723 |
| Total available-for-sale securities | <u>\$ 7,830</u> | <u>\$ —</u> | <u>\$ (101)</u> | <u>\$ 7,729</u> |
| December 31, 2017 | | | | |
| Available-for-sale securities: | | | | |
| Corporate bonds and notes | \$ 8,458 | \$ 19 | \$ (49) | \$ 8,428 |
| Municipal bonds | 4,637 | 1 | (28) | 4,610 |
| Total available-for-sale securities | <u>\$ 13,095</u> | <u>\$ 20</u> | <u>\$ (77)</u> | <u>\$ 13,038</u> |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

Maturities of marketable securities classified as available-for-sale securities were as follows at September 30, 2018:

| | Amortized cost | Estimated fair value |
|--|-----------------|----------------------|
| September 30, 2018 | | |
| Due within one year | \$ 1,982 | \$ 1,972 |
| Due after one year through five years | 5,848 | 5,757 |
| Due after five years | — | — |
| Total available-for-sale securities | \$ 7,830 | \$ 7,729 |

Debt securities in an unrealized loss position as of September 30, 2018 were not deemed impaired at acquisition and subsequent declines in fair value are not deemed attributed to declines in credit quality. Management believes that it is more likely than not that the securities will receive a full recovery of par value, although there can be no assurance that such recovery will occur. The available-for-sale marketable securities with continuous gross unrealized loss position for less than 12 months and 12 months or greater and their related fair values were as follows:

| | Less than 12 months | | More than 12 months | | Total | |
|---------------------------------|----------------------|---------------------------------|----------------------|---------------------------------|----------------------|---------------------------------|
| | Estimated fair value | Gross unrealized holding losses | Estimated fair value | Gross unrealized holding losses | Estimated fair value | Gross unrealized holding losses |
| <i>(In thousands)</i> | | | | | | |
| As of September 30, 2018 | | | | | | |
| Corporate bonds and notes | \$ 2,449 | \$ (19) | \$ 1,569 | \$ (30) | \$ 4,018 | \$ (49) |
| Municipal bonds | 2,618 | (41) | 913 | (11) | 3,531 | (52) |
| Total | \$ 5,067 | \$ (60) | \$ 2,482 | \$ (41) | \$ 7,549 | \$ (101) |

| | Less than 12 months | | More than 12 months | | Total | |
|--------------------------------|----------------------|---------------------------------|----------------------|---------------------------------|----------------------|---------------------------------|
| | Estimated fair value | Gross unrealized holding losses | Estimated fair value | Gross unrealized holding losses | Estimated fair value | Gross unrealized holding losses |
| <i>(In thousands)</i> | | | | | | |
| As of December 31, 2017 | | | | | | |
| Corporate bonds and notes | \$ 3,799 | \$ (20) | \$ 2,125 | \$ (30) | \$ 5,924 | \$ (50) |
| Municipal bonds | 3,341 | (18) | 657 | (9) | 3,998 | (27) |
| Total | \$ 7,140 | \$ (38) | \$ 2,782 | \$ (39) | \$ 9,922 | \$ (77) |

5. Intangible Assets

Intangible assets as of September 30, 2018 and December 31, 2017 consisted of the following:

| | Estimated useful lives (years) | September 30, 2018 | December 31, 2017 |
|-------------------------------------|--------------------------------|--------------------|-------------------|
| Tradename | 5 to 7 | \$ 555 | \$ 555 |
| Patents and technological know-how | 10 | 12,244 | 8,578 |
| Proprietary software | 3 to 15 | 2,981 | 2,981 |
| Other | 3 to 5 | 323 | 323 |
| Total intangible assets | | 16,103 | 12,437 |
| Accumulated amortization | | (6,685) | (5,894) |
| Total intangible assets, net | | \$ 9,418 | \$ 6,543 |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

The amortization of intangible assets for the three and nine months ended September 30, 2018 and 2017 was as follows:

| | <u>Three months ended September 30,</u> | | <u>Nine months ended September 30,</u> | |
|-----------------------------------|---|----------|--|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Amortization of intangible assets | \$ (279) | \$ (231) | \$ (791) | \$ (699) |

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

| <u>Years ending December 31,</u> | <u>Amount</u> |
|----------------------------------|---------------|
| 2018 (Remainder) | \$ 291 |
| 2019 | 1,110 |
| 2020 | 932 |
| 2021 | 932 |
| 2022 | 932 |
| Thereafter | 5,221 |
| Total | 9,418 |

6. Inventories

Inventories, net of reserves, as of September 30, 2018 and December 31, 2017 consisted of the following:

| | <u>As of</u> | |
|-----------------------------|---------------------------|--------------------------|
| | <u>September 30, 2018</u> | <u>December 31, 2017</u> |
| Current: | | |
| Raw materials | \$ 1,632 | \$ 197 |
| Finished goods | 11,667 | 14,218 |
| Total current inventories | <u>\$ 13,299</u> | <u>\$ 14,415</u> |
| Long-term: | | |
| Raw materials | \$ 1,931 | \$ 2,682 |
| Finished goods | 6,335 | 6,026 |
| Total long-term inventories | <u>\$ 8,266</u> | <u>\$ 8,708</u> |

Long-term inventory represents inventory held in excess of our current (next 12 months) requirements based on our recent sales and forecasted level of sales. We expect to sell the above inventory, net of reserves, at or above the stated cost and believe that no loss will be incurred on its sale, although there can be no assurance of the timing or amount of any sales.

Current finished goods did not include distributor channel inventories in the amounts of approximately \$1,555 as of December 31, 2017. Distributor channel inventories represented inventories at distributors and other customers where revenue recognition criteria had not yet been achieved.

Net loss incurred on valuation of inventory at lower of cost or market value and write-off of obsolete inventory during the three and nine months ended September 30, 2018 was \$45 and \$471, respectively. During the three months and nine months ended September 30, 2017 there was no net loss incurred on valuation of inventory at lower of cost or market value and write-off of obsolete inventory.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

7. Share-based Compensation

Employee Stock Option Plans

The Company's share-based incentive plans offering stock options are offered under the Company's 2007 Equity Incentive Plan (the "2007 Plan"), which was restated and approved by the shareholders on December 12, 2015. Provisions of the restated 2007 Plan include the granting of up to 2,000,000 incentive and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. Options may be granted to employees, officers, non-employee directors and other service providers and may be granted upon such terms as the Compensation Committee of the Board of Directors determines in their sole discretion. As of September 30, 2018, there were 706,091 options outstanding under the 2007 Plan. As of September 30, 2018, the 2007 Plan had 789,003 authorized unissued options.

A summary of the stock option activity under the Company's plans for the nine months ended September 30, 2018 is as follows:

| | <u>Number of shares</u> | <u>Weighted average exercise price</u> |
|---|-----------------------------|--|
| Options outstanding at beginning of year | 764,430 | \$ 8.78 |
| Granted | — | — |
| Less: | | |
| Exercised | — | — |
| Forfeited prior to vesting | (24,757) | 11.05 |
| Canceled or expired | (33,582) | 10.87 |
| Options outstanding at September 30, 2018 | <u>706,091</u> | <u>8.60</u> |
| Options exercisable at end of September 30, 2018 | <u>598,805</u> | <u>\$ 8.22</u> |

As of September 30, 2018, the total remaining unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately \$379, which will be recognized over a weighted average period of 1.32 years.

Share-based compensation expense has been recorded as follows:

| | <u>Three months ended September 30,</u> | | <u>Nine months ended September 30,</u> | |
|----------------------------------|---|---------------|--|---------------|
| | <u>2018</u> | <u>2017</u> | <u>2018</u> | <u>2017</u> |
| Cost of goods sold | \$ 3 | \$ 5 | \$ 12 | \$ 16 |
| Sales and marketing | 8 | 10 | 28 | 31 |
| Research and product development | 23 | 25 | 81 | 80 |
| General and administrative | 78 | 122 | 258 | 341 |
| | <u>\$ 112</u> | <u>\$ 162</u> | <u>\$ 379</u> | <u>\$ 468</u> |

8. Shareholders' Equity

Stock Repurchase Program

On March 9, 2016, the Board of Directors of the Company authorized the repurchase of up to \$10,000 of the Company's outstanding shares of common stock under a stock repurchase program. In connection with the repurchase authorization, the Company was authorized to complete the repurchase through open market transactions or through an accelerated share repurchase program, in each case to be executed at management's discretion based on business and market conditions, stock price, trading restrictions, acquisition activity and other factors. The transactions effectuated to date occurred in open market purchases.

On March 1, 2017, the Board of Directors of the Company renewed and extended the repurchase program for up to an additional \$10,000 of common stock over the next twelve months. In connection with the repurchase extension authorization, the Company was authorized to complete the repurchase through open market transactions or through an accelerated share repurchase program, in each case to be executed at management's discretion based on business and market conditions, stock price, trading restrictions, acquisition activity and other factors. The transactions effectuated to date occurred in open market purchases.

Upon expiry of this repurchase program in March 2018, the program was not renewed again.

Cash Dividends

On February 21, 2018, the Company declared a cash dividend of \$0.07 per share of ClearOne common stock. The dividend was paid on March 21, 2018 to shareholders of record as of March 7, 2018. On June 13, 2018, the Company announced the suspension of its dividend program.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

9. Fair Value Measurements

The fair value of the Company's financial instruments reflects the amounts that the Company estimates it will receive in connection with the sale of an asset or pay in connection with the transfer of a liability in an orderly transaction between market participants at the measurement date (exit price). The fair value hierarchy prioritizes the use of inputs used in valuation techniques into the following three levels:

Level 1 - Quoted prices in active markets for identical assets and liabilities.

Level 2 - Observable inputs other than quoted prices in active markets for identical assets and liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. This category generally includes U.S. Government and agency securities; municipal securities; mutual funds and securities sold and not yet settled.

Level 3 - Unobservable inputs.

The substantial majority of the Company's financial instruments are valued using observable inputs. The following table sets forth the fair value of the financial instruments re-measured by the Company as of September 30, 2018 and December 31, 2017:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|---------------------------|----------------|------------------|----------------|------------------|
| September 30, 2018 | | | | |
| Corporate bonds and notes | \$ - | \$ 4,006 | \$ - | \$ 4,006 |
| Municipal bonds | - | 3,723 | - | 3,723 |
| Total | <u>\$ -</u> | <u>\$ 7,729</u> | <u>\$ -</u> | <u>\$ 7,729</u> |
| December 31, 2017 | | | | |
| Corporate bonds and notes | \$ - | \$ 8,428 | \$ - | \$ 8,428 |
| Municipal bonds | - | 4,610 | - | 4,610 |
| Total | <u>\$ -</u> | <u>\$ 13,038</u> | <u>\$ -</u> | <u>\$ 13,038</u> |

10. Income Taxes

The Company routinely evaluates the likelihood of realizing the benefit of its deferred tax assets and may record a valuation allowance if, based on all available evidence, it determines that it is more likely than not some portion of the tax benefit will not be realized. As of September 30, 2018, the Company had an aggregate of approximately \$7.9 million in deferred tax assets primarily related to intangible assets, net operating losses, tax credit carryforwards, and inventory basis differences. On a quarterly basis, the Company tests the value of deferred tax assets for impairment at the taxpaying-component level within each tax jurisdiction. Significant judgment and estimates are required in determining whether valuation allowances should be established as well as the amount of such allowances. When making such determination, consideration is given to, among other things, the following:

- sufficient taxable income within the allowed carryback or carryforward periods;
- future reversals of existing taxable temporary differences, including any tax planning strategies that could be utilized;
- nature or character (e.g., ordinary vs. capital) of the deferred tax assets and liabilities; and
- future taxable income exclusive of reversing temporary differences and carryforwards.

Based on the foregoing criteria, the Company determined that it no longer meets the "more likely than not" threshold that net operating losses, tax credits and other deferred tax assets will be realized. Accordingly, the Company recorded a full valuation allowance at September 30, 2018.

The Company's forecasted effective tax benefit rate at September 30, 2018 is 0%, as compared to the 10.8% effective tax rate recorded at December 31, 2017. The 10.8% decrease is primarily due to not recognizing benefit in 2018-Q3 for pre-tax losses and credits, as a result of the Company's full valuation allowance on net deferred tax assets.

The Company recorded discrete tax expense of \$6.5M in 2018-Q3, due primarily to the recording of a full valuation allowance on the Company's net deferred tax assets.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited - Dollars in thousands, except per share amounts)

11. Subsequent Events

On October 25, 2018, the Company completed its reincorporation from a Utah corporation to a Delaware corporation (the "Reincorporation"). The Reincorporation was approved by shareholders of the Company at the Company's annual meeting of Shareholders on October 25, 2018.

On November 5, 2018, the Company commenced a rights offering pursuant to which each shareholder of record as of November 5, 2018 shall be entitled to purchase one (1) share of the Company's common stock at a subscription price of \$1.20 per whole share (the "Basic Subscription Right"), or a maximum of 8,306,535 shares. If a shareholder exercises its Basic Subscription Right in full and other shareholders do not fully exercise their Basic Subscription Rights, a shareholder will have an over-subscription right to purchase the same number of shares of the Company's common stock that it may acquire pursuant to the exercise of its Basic Subscription Right, at the same subscription price of \$1.20 per whole share, additional shares of common stock that remain unsubscribed at the expiration of the rights offering. Over-subscription rights will be available only to shareholders who exercise their basic subscription rights in full. The over-subscription rights will be subject to availability and pro rata allocation of shares among shareholders exercising their over-subscription right. The rights offering will expire on Monday, November 19, 2018 at 5:00 p.m. Eastern Standard Time. The rights offering is being conducted pursuant to a registration statement on Form S-1 that was declared effective by the Securities and Exchange Commission on November 5, 2018 and the prospectus dated November 5, 2018 included therein.

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

This report on Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements in this report, other than statements of historical fact, are forward-looking statements for purposes of these provisions, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance, and any statements of assumptions underlying any of the foregoing. All forward-looking statements included in this report are made as of the date hereof and are based on information available to us as of such date. We assume no obligation to update any forward-looking statement. In some cases, forward-looking statements can be identified by the use of terminology such as "may," "will," "expects," "plans," "anticipates," "intends," "believes," "estimates," "potential," or "continue," or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are based upon reasonable assumptions at the time made, there can be no assurance that any such expectations or any forward-looking statement will prove to be correct. Our actual results will vary, and may vary materially, from those projected or assumed in the forward-looking statements. Future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, many of which we cannot predict with accuracy and some of which we might not anticipate, including, without limitation, product recalls and product liability claims; infringement of our technology or assertion that our technology infringes the rights of other parties; termination of supplier relationships, or failure of suppliers to perform; inability to successfully manage growth; delays in obtaining regulatory approvals or the failure to maintain such approvals; concentration of our revenue among a few customers, products or procedures; development of new products and technology that could render our products obsolete; market acceptance of new products; introduction of products in a timely fashion; price and product competition, availability of labor and materials, cost increases, and fluctuations in and obsolescence of inventory; volatility of the market price of our common stock; foreign currency fluctuations; changes in key personnel; work stoppage or transportation risks; integration of business acquisitions; and other factors referred to in our reports filed with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2017. All subsequent forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Additional factors that may have a direct bearing on our operating results are discussed in Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 and in Part II, Item 1A "Risk Factors" in this Quarterly Report on Form 10-Q for the quarter ended September 30, 2018.

BUSINESS OVERVIEW

ClearOne is a global market leader enabling conferencing, collaboration, and network streaming solutions. The performance and simplicity of our advanced, comprehensive solutions offer unprecedented levels of functionality, reliability and scalability.

We derive most of our revenue from professional audio conferencing products by promoting our products in the professional audio-visual channel. We have extended our total addressable market from installed audio conferencing market to adjacent complementary markets – microphones, video collaboration and networked audio and video streaming. We have achieved this through strategic technological acquisitions as well as by internal product development.

During the nine months ended September 30, 2018, seven more patents related to video synchronization, speech technology, integrated microphone array and ceiling or wall tile, echo cancellation with beamforming microphone array, audio distribution over local area networks, and USB to Bluetooth audio bridging were issued to us. During the nine months ended September 30, 2018, we continued our serious litigation efforts to stop infringement of two of our strategic patents. We introduced a new ceiling microphone array product line and made improvements to our VIEW Pro and Converge Pro 2 product lines. We also launched many new products including Collaborate Space, Converge Amplifier and wireless microphone systems in 537-563 MHz range at our industry's largest trade show in North America. We have also been focusing on company-wide cost cutting programs and speeding up product development that we believe will enable us to surpass our competitors.

Overall revenue declined in the three and nine months ended September 30, 2018 when compared to the three months and nine months ended September 30, 2017, with declines seen in all product categories. Our gross profit margin decreased to 45% during the three months ended September 30, 2018 from 62% for the three months ended September 30, 2017. Gross profit margin decreased primarily due to an increase in inventory obsolescence costs, a decline in licensing revenues and reduced overhead absorption into inventory as we continue to reduce our net spend on inventory. Our gross profit margin decreased to 49% during the nine months ended September 30, 2018 from 59% for the nine months ended September 30, 2017. Gross profit margin decrease was primarily due to an increase in inventory obsolescence costs, a decline in licensing revenues, and reduced overhead absorption into inventory. The proportion of overhead costs absorbed into inventory has declined due to a sharp decline in our inventory purchasing activity causing increased amounts of overhead costs to be expensed.

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

We operate in a very dynamic and highly competitive industry which is dominated on the one hand by a few players with respect to certain products like traditional video conferencing appliances while on the other influenced heavily by a fragmented reseller market consisting of numerous regional and local players. The industry is also characterized by the influx of venture capitalist funded start-ups and private companies keen to win market share even at the expense of mounting financial losses.

Economic conditions, challenges and risks

The audio-visual products market is characterized by intense competition and rapidly evolving technology. Our competitors vary within each product category. The adoption of Beamforming Microphone Array 2, along with our Converge Pro 2, our new platform for professional audio conferencing, remains challenged in large part because of our competitors' product offering that directly infringes our strategic patents. The patent infringement also has had a material adverse effect on revenue from ClearOne's other products like wireless microphones, ceiling microphones and video products.

Our revenues in the near term may also be adversely affected by the resignation of a large US distributor in June 2018.

Our strength in the professional audio visual space is largely due to our industry leading conferencing technologies and the full suite of professional microphone products, especially Beamforming Microphone Arrays. Despite our strong leadership position in the professional audio communications products market, we face challenges to revenue growth due to the infringement of our patents by competitors, the limited size of the market and pricing pressures from new competitors attracted to the commercial market.

During 2018, revenue from our video products has generally shown lesser decline than revenue from audio conferencing products. However, this is not an identifiable trend given the continuing change in the competitive landscape and also the uncertainty relating to revenue from our core product set due to patent infringement and ensuing litigation. We face intense competition in this market from well-established market leaders as well as emerging players rich with marketing funds. We expect our strategy of combining Spontania, our cloud-based video conferencing product, Collaborate, our appliance-based media collaboration product and our high-end audio conferencing technology to distinguish us from our competitors' product offerings.

We derive a large portion of our revenue (about 47%) from international operations and expect this trend to continue in the future. Most of our revenue from outside the U.S. is billed in US Dollars and is not exposed to any significant currency risk.

A detailed discussion of our results of operations follows below.

Results of Operations for the three and nine months ended September 30, 2018

The following table sets forth certain items from our unaudited condensed consolidated statements of operations (dollars in thousands) for the three and nine months ended September 30, 2018 ("2018-Q3") ("2018YTD") and 2017 ("2017-Q3") ("2017-YTD"), respectively, together with the percentage of total revenue which each such item represents:

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---|----------------------------------|------------|--------------------------------|---------------------------------|-------------|--------------------------------|
| | 2018 | 2017 | Percentage Change 2018 vs 2017 | 2018 | 2017 | Percentage Change 2018 vs 2017 |
| Revenue | \$ 6,683 | \$ 10,560 | -37% | \$ 20,943 | \$ 32,549 | -36% |
| Cost of goods sold | 3,703 | 4,051 | -9% | 10,614 | 13,293 | -20% |
| Gross profit | 2,980 | 6,509 | -54% | 10,329 | 19,256 | -46% |
| Sales and marketing | 2,168 | 3,006 | -28% | 7,796 | 8,393 | -7% |
| Research and product development | 1,781 | 2,268 | -21% | 5,757 | 6,947 | -17% |
| General and administrative | 1,341 | 1,281 | 5% | 4,500 | 5,597 | -20% |
| Impairment of intangibles | — | 736 | -100% | — | 736 | -100% |
| Impairment of goodwill | — | 12,724 | -100% | — | 12,724 | -100% |
| Operating loss | (2,310) | (13,506) | 83% | (7,724) | (15,141) | 49% |
| Other income, net | 5 | 78 | -94% | 78 | 264 | -70% |
| Loss before income taxes | (2,305) | (13,428) | 83% | (7,646) | (14,877) | 49% |
| Provision for (benefit from) income taxes | 7,837 | (4,152) | 289% | 6,505 | (4,313) | 251% |
| Net loss | \$ (10,142) | \$ (9,276) | -9% | \$ (14,151) | \$ (10,564) | -34% |

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

Revenue

Our revenue decreased by \$3.9 million, or 37%, to \$6.7 million in 2018-Q3 compared to \$10.6 million in 2017-Q3. All product categories witnessed revenue declines with revenue declines of 31%, 28% and 55% for professional audio conferencing, unified communication end points and video products, respectively. The decline in revenue from professional audio conferencing products was mostly due to slower adoption of our Converge Pro 2 platform, largely caused by our competitors' product offering that we believe directly infringes our strategic patents and due to a decline in licensing revenue. The share of professional audio communications products (which includes microphone products but not premium products) in our product mix increased from 66% in 2017-Q3 to 72% in 2018-Q3. Share of video products in the revenue during 2018-Q3 decreased from 24% in 2017-Q3 to 17% in 2018-Q3. Share of UC end points in the revenue increased from 10% in 2017-Q3 to 12% in 2018-Q3. During 2018-Q3, revenue declined across all regions except Canada and parts of Europe. The revenue declines for Asia Pacific including Middle East, Europe and Africa, and Americas were 53%, 13% and 30%, respectively.

Costs of Goods Sold and Gross Profit

Cost of goods sold ("COGS") includes expenses associated with finished goods purchased from outsourced manufacturers, the manufacture of our products (including material and direct labor), our manufacturing and operations organization, property and equipment depreciation, warranty expense, freight expense, royalty payments, and the allocation of overhead expenses.

Our gross profit for 2018-Q3 was approximately \$3.0 million or 45% compared to approximately \$6.5 million, or 62%, for 2017-Q3. Gross margin for 2018-Q3 declined due to an increase in inventory obsolescence costs, a decline in licensing revenues and reduced overhead absorption into inventory. The proportion of overhead costs absorbed into inventory has declined due to a sharp decline in our inventory purchasing activity causing increased amounts of overhead costs to be expensed rather than being carried with our inventory. Even though the total overhead spending has not increased, the combination of lower revenues and lower absorption has caused gross margin as a percentage of revenue to decline. 2017-Q3 included a large overseas project with a high margin - the absence of a similar project in 2018-Q3 also contributed to comparative decline in gross margin in 2018-Q3 and 2018YTD.

Our gross profit for 2018YTD was approximately \$10.3 million or 49% compared to approximately \$19.3 million, or 59%, for 2017YTD. Gross margin for 2018YTD declined due to increased inventory obsolescence costs, a decline in licensing revenues and due to lower absorption of overhead costs into inventory.

Our profitability in the near-term continues to depend significantly on our revenues from professional audio conferencing products. We hold long-term inventory and if we are unable to sell our long-term inventory, our profitability might be affected by inventory write-offs and price mark-downs. Our long-term inventory includes approximately \$2.7 million of wireless microphones related finished goods and assemblies, \$2.4 million of Converge Pro 2 products and about \$1.1 million of raw materials that will be used for manufacturing professional audio conferencing products. Any business changes that are adverse to these product lines could potentially impact our ability to sell these long-term inventory in addition to our current inventory.

Operating Expenses

Operating expenses include sales and marketing ("S&M") expenses, research and product development ("R&D") expenses and general and administrative ("G&A") expenses. Total operating expenses were \$5.3 million for 2018-Q3 compared to \$20.0 million for 2017-Q3. Total operating expenses for 2018YTD were \$18.1 million compared to \$34.3 million for 2017YTD. Total operating expenses in 2017-Q3 and 2017YTD included impairment of the goodwill and intangibles of \$13.4 million

The following contains a more detailed discussion of expenses related to sales and marketing, research and product development, general and administrative, and other items.

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

S&M expenses for 2018-Q3 decreased to \$2.2 million from \$3.0 million for 2017-Q3. The decrease was mainly due to decreases in employee related costs, commissions to employees and independent reps, payments to consultants and tradeshow related expenses. S&M expenses for 2018YTD increased to \$7.8 million from \$8.4 million for 2017YTD. The decrease was mainly due to decreases in employee related costs, commissions to employees and independent reps and payments to consultants.

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

Research and Product Development - R&D expenses include research and development, product line management, engineering services, and test and application expenses, including employee related costs, outside services, expensed materials, depreciation, and an allocation of overhead expenses.

R&D expenses were approximately \$1.8 million for 2018-Q3, as compared to \$2.3 million for 2017-Q3. The decrease was primarily due to reductions in project related expenses and employee costs related to salaries and benefits. R&D expenses were approximately \$5.8 million for 2018YTD, as compared to \$6.9 million for 2017YTD. The decrease was primarily due to reductions in project related expenses and employee costs related to salaries and benefits.

General and Administrative - G&A expenses include employee-related costs, professional service fees, allocations of overhead expenses, litigation costs, and corporate administrative costs, including costs related to finance and human resources.

G&A expenses remained the same at \$1.3 million in 2017-Q3 and 2018-Q3. In 2018-Q3 and 2017-Q3 legal costs related to our defense of strategic patents from infringement amounting to \$1.2 and \$0.8 million, respectively were capitalized.

G&A expenses in 2018YTD was \$4.5 million compared to \$5.6 million in 2017YTD. The decline of approximately 20% was primarily due to the decrease in legal costs and employee costs related to salaries and benefits. Legal expenses in 2018YTD decreased mostly because of capitalization of legal costs related to our defense of strategic patents from infringement amounting to \$3.6 million in 2018YTD compared to \$0.8 million capitalized in 2017 YTD.

Impairment of Goodwill and an intangible asset - At the end of September 30, 2017, based on the results of the Company's impairment analysis the Company recognized a charge of \$12.7 million towards goodwill impairment and \$0.7 million towards the intangible asset impairment for the three and nine months ended September 30, 2017. There were no such impairment charges in 2018-Q3 or 2018YTD.

Other income (expense), net

Other income (expense), net, includes interest income, interest expense, and foreign currency changes.

Other income reduced in 2018-Q3 and 2018YTD due to reduction in interest income caused by decline in the investment holdings and due to higher realized losses on liquidated investments.

Provision for income taxes

During the nine months ended September 30, 2018, we accrued income taxes at the forecasted effective tax benefit rate of 0% as compared to the forecasted effective tax benefit rate of 36.1% used during the nine months ended September 30, 2017. The 36.1% decrease in the forecasted effective tax benefit rate was primarily due to the recording in 2018-Q3 of a full valuation allowance on the Company's net deferred tax assets.

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2018, our cash and cash equivalents were approximately \$2.5 million compared to \$5.6 million as of December 31, 2017. Our working capital was \$20.2 million and \$23.3 million as of September 30, 2018 and December 31, 2017, respectively.

Net cash used in operating activities was approximately \$3.5 million for the nine months ended September 30, 2018, a decrease of cash used of approximately \$4.1 million from \$7.6 million of cash used in operating activities in the nine months ended September 30, 2017. The decrease in cash used was primarily due to an increase in cash inflows due to change in operating assets and liabilities of \$9.0 million partially offset by an increase in net loss by \$3.6 million and decrease in non-cash charges of \$1.3 million.

Net cash provided by investing activities was \$1.3 million for the nine months ended September 30, 2018 compared to net cash flows provided by investing activities of \$4.4 million during the nine months ended September 30, 2017, a decrease in cash provided of \$3.2 million. The decrease was due to increase in capitalization of patent defense costs by \$2.7 million and decrease in proceeds from marketable securities net of purchases of approximately \$0.8 million, partially offset by a decline in purchases of property and equipment and intangibles.

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

Capitalization of patent defense costs. We capitalize external legal costs incurred in the defense of our patents when we believe that a significant, discernible increase in value will result from the defense and a successful outcome of the legal action is probable. When we capitalize patent defense costs we amortize the costs over the remaining estimated useful life of the patent, which is 15 to 17 years. During the nine months ended September 30, 2018 we spent \$3.6 million of legal costs related to the defense of our patents and capitalized the entire amount.

Net cash used in financing activities was approximately \$0.7 million during the nine months ended September 30, 2018, which mainly consisted of cash outflows of \$0.1 million on repurchase and cancellation of stock and \$0.6 million for dividend payments. Net cash used in financing activities was approximately \$6.0 million during the nine months ended September 30, 2017, which consisted of cash outflows of \$4.4 million on repurchase and cancellation of stock and stock options and \$1.7 million for dividend payments.

We are currently pursuing all available legal remedies to defend our strategic patents from infringement. We have already incurred approximately \$7.4 million in expenses from 2016 through September 30, 2018 towards this litigation and may be required to incur more to continue to enforce our patents. We have been actively engaged in preserving cash by suspending our dividend program, allowing the share repurchase program to expire and implementing company-wide cost reduction measures. In addition, we expect to generate additional cash from our rights offering that we commenced on November 5, 2018 and as our inventory levels are brought down to historical levels. We also believe that the measures taken by us will yield higher revenues in the future. We believe all of these and effective management of working capital will provide the liquidity needed to meet our short-term and long-term operating requirements and finance our growth plans. We also believe that our strong portfolio of intellectual property and our solid brand equity in the market will enable us to raise additional capital if and when needed to meet our short and long-term financing needs. In addition to capital expenditures, we may use cash in the near future for selective infusions of technology, sales and marketing, infrastructure, and other investments to fuel our growth.

At September 30, 2018, we had open purchase orders related to our electronics manufacturing service providers of approximately \$2.7 million, primarily related to inventory purchases.

At September 30, 2018, we had inventory totaling \$21.6 million, of which non-current inventory accounted for \$8.3 million. This compares to total inventories of \$24.7 million and non-current inventory of \$8.7 million as of December 31, 2017. Our non-current inventory includes approximately \$2.7 million of wireless microphones related finished goods and assemblies, \$2.4 million of Converge Pro 2 products and about \$1.1 million of raw materials that will be used for manufacturing professional audio conferencing products. Any business changes that are adverse to these product lines could potentially impact our ability to sell these long-term inventory in addition to our current inventory.

OFF-BALANCE SHEET ARRANGEMENTS

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our results of operations and financial position are based upon our unaudited consolidated financial statements included under Item 1 of this Form 10-Q, which have been prepared in conformity with accounting principles generally accepted in the United States. We review the accounting policies used in reporting our financial results on a regular basis. We believe certain of our accounting policies are critical to understanding our financial position and results of operations. Except with respect to our revenue recognition practices included in Note 1. "Business Description, Basis of Presentation and Significant Accounting Policies" under Item 1 of this Form 10-Q, there have been no changes to the critical accounting policies as explained in our 2017 Form 10-K.

RECENT ACCOUNTING PRONOUNCEMENTS

For a discussion of recent accounting pronouncements, see Note 3: "Recent Accounting Pronouncements" in the notes to our unaudited consolidated financial statements included under Item 1 of this Form 10-Q.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

An evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of September 30, 2018 was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Principal Financial and Accounting Officer. Based upon this evaluation, our Chief Executive Officer and Senior Vice President of Finance concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were not effective at a reasonable assurance level as of September 30, 2018 due to the material weakness in internal control over financial reporting as described below.

Management identified a material weakness in the operating effectiveness of internal control over financial reporting relating to the accurate and timely reporting of its financial results and disclosures and its testing and assessment of the design and effectiveness of internal controls over financial reporting in a timely manner.

To address the material weakness, management is working with our third party internal controls consultant to assist with the implementation of a remediation plan which will supplement the existing controls. The remediation plan will include an assessment of personnel levels and responsibilities, additional training of financial reporting personnel and ability to handle new requirements and projects on a timely basis with respect to the preparation of the consolidated financial statements and public company reporting requirements and timelines. The material weakness will be fully remediated when, in the opinion of management, the control processes have been operating for a sufficient period of time to provide reasonable assurance as to their effectiveness. The remediation and ultimate resolution of the material weakness will be reviewed with the Audit Committee of the Board of Directors.

Except as noted above, there has been no change in the Company's internal control over financial reporting as of September 30, 2018, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The following risk factor supplements the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017:

Our stock price may in the future not meet the minimum bid price for continued listing on the Nasdaq Capital Market. Our ability to publicly or privately sell equity securities and the liquidity of our common stock could be adversely affected if we are delisted from The Nasdaq Capital Market.

Nasdaq Listing Rule 5450(a)(1) provides that the closing bid price for our common stock may not be below \$1.00 per share for any period of 30 consecutive trading days to maintain our continued listing on The Nasdaq Capital Market ("Minimum Bid Price Rule"). Although we are currently in compliance with the Minimum Bid Price Rule, there can be no assurance that our common stock will continue to satisfy this rule. If we were to fail to comply with the Minimum Bid Price Rule in the future and became subject to delisting, such delisting from Nasdaq would adversely affect our ability to raise additional financing through the public or private sale of equity securities, would significantly affect the ability of investors to trade our securities and would negatively affect the value and liquidity of our common stock. Delisting also could have other negative results, including the potential loss of confidence by employees, the loss of institutional investor interest and fewer business development opportunities.

There have been no material developments in the legal proceedings described in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 1A. RISK FACTORS

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

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

(a) None.

(b) Not applicable.

(c) None.

Upon expiry of this repurchase program in March 2018, the program was not renewed again.

Item 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

Not applicable.

Item 6. EXHIBITS

| Exhibit No. | Title of Document |
|--------------------|---|
| 3.1 | Certificate of Incorporation of ClearOne, Inc., as filed with the Secretary of the State of Delaware on October 25, 2018 (filed as Exhibit 3.1 to the Company's Current Report on Form 8-K as filed with the SEC on October 29, 2018 and incorporated herein by reference). |
| 3.2 | Bylaws of ClearOne, Inc. (filed as Exhibit 3.2 to the Company's Current Report on Form 8-K as filed with the SEC on October 29, 2018 and incorporated herein by reference). |
| 31.1 | Section 302 Certification of Chief Executive Officer (filed herewith). |
| 31.2 | Section 302 Certification of Principal Financial Officer (filed herewith). |
| 32.1 | Section 906 Certification of Chief Executive Officer (filed herewith). |
| 32.2 | Section 906 Certification of Principal Financial Officer (filed herewith). |
| 101.INS | XBRL Instance Document (filed herewith) |
| 101.SCH | XBRL Taxonomy Extension Schema (filed herewith) |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase (filed herewith) |
| 101.DEF | XBRL Taxonomy Extension Definitions Linkbase (filed herewith) |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase (filed herewith) |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase (filed herewith) |

SIGNATURES

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

ClearOne, Inc.,
(Registrant)

By: /s/ Zeynep Hakimoglu

Zeynep Hakimoglu

President, Chief Executive Officer and Chairman of the Board
(Principal Executive Officer)

November 9, 2018

By: /s/ Narsi Narayanan

Narsi Narayanan

Senior Vice President of Finance

(Principal Accounting and Principal Financial Officer)

November 9, 2018

CERTIFICATION

I, Zeynep Hakimoglu, certify that:

1. I have reviewed this quarterly report of ClearOne, Inc. on Form 10-Q;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Zeynep Hakimoglu

Zeynep Hakimoglu

Chief Executive Officer

(Principal Executive Officer)

November 9, 2018

CERTIFICATION

I, Narsi Narayanan, certify that:

1. I have reviewed this quarterly report of ClearOne, Inc. on Form 10-Q;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

By: /s/ Narsi Narayanan

Narsi Narayanan

Senior Vice President of Finance

(Principal Accounting and Principal Financial Officer)

November 9, 2018

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

**Pursuant to 18 U.S.C. Section 1350,
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

I, Zeynep Hakimoglu, certify, to my best knowledge and belief, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of ClearOne, Inc. on Form 10-Q for the quarter ended September 30, 2018 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of ClearOne, Inc.

By: */s/ Zeynep Hakimoglu*

Zeynep Hakimoglu
Chief Executive Officer
(Principal Executive Officer)

November 9, 2018

CERTIFICATION OF CHIEF FINANCIAL OFFICER

**Pursuant to 18 U.S.C. Section 1350,
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

I, Narsi Narayanan, certify, to my best knowledge and belief, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of ClearOne, Inc. on Form 10-Q for the quarter ended September 30, 2018, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of ClearOne, Inc.

By: */s/ Narsi Narayanan*

Narsi Narayanan

Senior Vice President of Finance

(Principal Accounting and Principal Financial Officer)

November 9, 2018