Digimarc CORP
Form 10-Q
July 31, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009

OR

o **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)

Delaware	**26-2828185**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer 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)

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 ý No o

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 o No o

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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company ý

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

As of July 27, 2009, there were 7,291,842 shares of the registrant's common stock, par value $0.001 per share, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

DIGIMARC CORPORATION

BALANCE SHEETS

(In thousands, except share data)

(UNAUDITED)

	Successor June 30, 2009	Successor December 31, 2008(1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,586	$ 18,928
Marketable securities	31,815	21,240
Trade accounts receivable, net	2,709	3,839
Other current assets	920	875
Total current assets	47,030	44,882
Marketable securities	2,087	5,744
Property and equipment, net	1,161	1,212
Intangibles, net	892	456
Other assets, net	372	147
Total assets	$ 51,542	$ 52,441
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 978	$ 937
Accrued payroll and related costs	199	42
Accrued merger related liabilities	176	386
Deferred revenue	1,907	2,418
Total current liabilities	3,260	3,783
Long-term liabilities	189	257
Total liabilities	3,449	4,040
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock (10,000 shares issued and outstanding at June 30, 2009 and December 31, 2008)	50	50
Common stock (7,291,842 and 7,279,442 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively)	7	7
Additional paid-in capital	49,447	48,268
Retained earnings (accumulated deficit)	(1,411)	76
Total stockholders' equity	48,093	48,401
Total liabilities and stockholders' equity	$ 51,542	$ 52,441

(1) Derived from the Company's December 31, 2008 audited financial statements

See Notes to Unaudited Financial Statements.

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DIGIMARC CORPORATION

STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(UNAUDITED)

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008
Revenue:				
Service	$ 2,585	$ 2,987	$ 5,055	$ 5,535
License and subscription	1,739	2,128	3,698	4,665
Total revenue	4,324	5,115	8,753	10,200
Cost of revenue:				
Service	1,480	1,643	2,897	2,992
License and subscription	48	61	116	120
Total cost of revenue	1,528	1,704	3,013	3,112
Gross profit	2,796	3,411	5,740	7,088
Operating expenses:				
Sales and marketing	728	683	1,473	1,339
Research, development and engineering	1,217	910	2,488	1,832
General and administrative	1,496	927	3,184	1,907
Intellectual property	217	448	494	926
Transitional services	(48)		(108)	
Total operating expenses	3,610	2,968	7,531	6,004
Operating income (loss)	(814)	443	(1,791)	1,084
Other income, net	140	221	313	515
Income (loss) before provision for income taxes	(674)	664	(1,478)	1,599
Provision for income taxes	(4)		(9)	(11)
Net income (loss)	$ (678)	$ 664	$ (1,487)	$ 1,588
Loss per share:				
Net loss per share basic	$ (0.09)		$ (0.21)	
Net loss per share diluted	$ (0.09)		$ (0.21)	
Weighted average shares outstanding basic	7,158		7,158	
Weighted average shares outstanding diluted	7,158		7,158	
Pro-forma earnings per share:				
Net income per share basic		$ 0.09		$ 0.22
Net income per share diluted		$ 0.09		$ 0.22
Weighted average shares outstanding basic		7,143		7,143
Weighted average shares outstanding diluted		7,143		7,143

See Notes to Unaudited Financial Statements.

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DIGIMARC CORPORATION

STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share data)

(UNAUDITED)

	Preferred stock		Common stock		Additional paid-in capital	Retained Earnings (Accumulated Deficit)	Net Parent Investment	Total stockholders' equity
	Shares	Amount	Shares	Amount				
PREDECESSOR								
BALANCE AT AUGUST 1, 2008		$		$	$	$	$ 47,793	$ 47,793
SUCCESSOR								
August 2, 2008: Stock issued through spin-off of Digimarc	10,000	$ 50	7,143,442	$ 7	$ 47,736	$	$ (47,793)	$
Issuance of common stock								
Issuance of restricted common stock			136,000					
Stock compensation expense					532			532
Net income						76		76
BALANCE AT DECEMBER 31, 2008	10,000	$ 50	7,279,442	$ 7	$ 48,268	$ 76	$	$ 48,401
Issuance of restricted common stock			12,400					
Stock compensation expense					1,179			1,179
Net loss						(1,487)		(1,487)
BALANCE AT JUNE 30, 2009	10,000	$ 50	7,291,842	$ 7	$ 49,447	$ (1,411)	$	$ 48,093

See Notes to Unaudited Financial Statements.

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DIGIMARC CORPORATION

STATEMENTS OF CASH FLOWS

(In thousands)

(UNAUDITED)

	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008
Cash flows from operating activities:		
Net income (loss)	$ (1,487)	$ 1,588
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	276	446
Stock-based compensation expense	1,179	777
Changes in operating assets and liabilities:		
Trade accounts receivable, net	1,130	(452)
Other current assets	(45)	(12)
Other assets, net	(225)	(10)
Accounts payable and other accrued liabilities	40	24
Accrued payroll and related costs	157	393
Accrued merger related liabilities	(210)	
Deferred revenue	(513)	132
Other liabilities	(57)	(8)
Net cash provided by operating activities	245	2,878
Cash flows from investing activities:		
Purchase of property and equipment	(214)	(559)
Capitalized patent costs	(447)	
Sale or maturity of marketable securities	15,685	103,395
Purchase of marketable securities	(22,603)	(103,676)
Net cash used in investing activities	(7,579)	(840)
Cash flows from financing activities:		
Cash from Parent stock activity		2,335
Net activity with Parent		(453)
Principal payments under capital lease obligations	(8)	
Net cash provided by (used in) financing activities	(8)	1,882
Net increase (decrease) in cash and cash equivalents	(7,342)	3,920
Cash and cash equivalents at beginning of period	18,928	29,145
Cash and cash equivalents at end of period	$ 11,586	$ 33,065
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 2	$ 4
Cash paid for income taxes	$ 9	$ 11

See Notes to Unaudited Financial Statements.

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Digimarc Corporation ("Digimarc" or the "Company") 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. The Company's technology provides the means to infuse persistent digital information, perceptible only to computers and digital devices, into all forms of media content. 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. The Company's technology permits computers and digital devices to quickly identify relevant data from vast amounts of media content.

Acquisition of Old Digimarc and Separation of DMRC Corporation

On June 29, 2008, the former Digimarc Corporation ("Old Digimarc") entered into an amended and restated merger agreement, as amended by Amendment No. 1 dated as of July 17, 2008, which we refer to as the Old Digimarc/L-1 merger agreement, with L-1 Identity Solutions, Inc. ("L-1") and Dolomite Acquisition Co. ("Dolomite"), a wholly owned subsidiary of L-1, pursuant to which Dolomite, in a transaction which we refer to as the offer, purchased more than 90% of the outstanding shares of Old Digimarc common stock, together with the associated preferred stock purchase rights, for $12.25 per share. On August 13, 2008, following the completion of the offer, Dolomite merged with and into Old Digimarc with Old Digimarc continuing as the surviving company and a wholly owned subsidiary of L-1.

On August 1, 2008, prior to the initial expiration of the offer, Old Digimarc contributed all of the assets and liabilities related to its digital watermarking business, which we refer to as the Digital Watermarking Business, together with all of Old Digimarc's cash, to DMRC LLC. Following the restructuring, all of the limited liability company interests of DMRC LLC were transferred to a newly created trust for the benefit of Old Digimarc record holders. DMRC LLC then merged with and into DMRC Corporation, and each limited liability company interest of DMRC LLC was converted into one share of common stock of DMRC Corporation. After completion of the Old Digimarc/L-1 merger, DMRC Corporation changed its name to Digimarc Corporation. The shares of Digimarc common stock were held by the trust until the Form 10, *General Form for Registration of Securities*, was declared effective by the Securities and Exchange Commission ("SEC") on October 16, 2008, at which time the shares were distributed to Old Digimarc record holders, as beneficiaries of the trust, pro rata in accordance with their ownership of shares of Old Digimarc common stock on August 1, 2008 at 5:30 pm Eastern time, the spin-off record date and time. Each Old Digimarc record holder was entitled to receive one share of Digimarc common stock for every three and one half shares of Old Digimarc common stock held by the stockholder as of the spin-off record date and time.

Joint Venture and Patent License Agreements with The Nielsen Company

On June 11, 2009 the Company entered into two joint venture agreements with The Nielsen Company ("Nielsen") to launch two new companies. The two joint venture agreements and a revised patent license agreement expand and replace the previous license and services agreement between the Company and Nielsen that has been in operation since late 2007. Under the new agreements, the

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies (Continued)

Company and Nielsen plan to work together to develop new products and services, including the expansion and deployment of those product and services that were in development under the prior agreement.

Under the terms of the patent license agreement, Nielsen agreed to pay Digimarc $18,750 during the period from July 2009 through January 2014, and Digimarc granted to Nielsen a non-exclusive license to the Digimarc's patents for use within Nielsen's business.

Joint venture I, TVaura LLC, will engage in the development of copyright filtering solutions, royalty/audit solutions for online video and audio rights organizations, guilds or other organizations involved in reconciliation of royalties, residuals and other payments, and other related products. Each of the Company and Nielsen will make an initial cash contribution aggregating $3,900 payable quarterly from July 2009 through October 2011. The Company will provide technical and development services to TVaura LLC's business for the following periods for the following minimum service fees: $1,130 for the remainder of 2009; $2,800 in 2010; and $2,740 in 2011, subject to adjustment for any development service fees paid to the Company by TVaura Mobile LLC.

Joint venture II, TVaura Mobile LLC, will engage in the development of certain enhanced television offerings, and other related products. Each of the Company and Nielsen will make an initial cash contribution aggregating $2,800 payable quarterly from July 2009 through October 2011.

Pursuant to the terms of the agreements and Emerging Issues Task Force ("EITF") Issue No. 96-16, "*Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholders Have Certain Approval or Veto Rights,*" the joint ventures will not be consolidated with the Company and will be separately disclosed in the financial statements and notes to financial statements.

Interim Financial Statements

The accompanying financial statements have been prepared from the Company's records without audit and, in management's opinion, include all adjustments (consisting of only normal recurring adjustments) necessary to fairly reflect the financial condition and the results of operations for the periods presented. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (the "U.S.") have been condensed or omitted in accordance with the rules and regulations of the SEC.

These financial statements should be read in conjunction with the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, which was filed with the SEC on February 27, 2009. The results of operations for the interim periods presented in these financial statements are not necessarily indicative of the results for the full year.

Basis of Accounting; Predecessor Financial Statements

The predecessor financial statements include certain accounts of Old Digimarc and the assets, liabilities and results of operations of Old Digimarc's Digital Watermarking Business that were separated, or "carved-out" from Old Digimarc. The operating expenses included in the predecessor financial statements include proportional allocations of various shared services common costs of Old

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies (Continued)

Digimarc because specific identification of the expenses was not practicable. The common costs include expenses from Old Digimarc related to various operating shared services cost centers, including executive, finance and accounting, human resources, legal, marketing, intellectual property, facilities and information technology.

Management believes that the assumptions underlying the predecessor financial statements are reasonable. The cost allocation methods applied to certain shared services common cost centers include the following:

Specific identification. Where the amounts were specifically identified to the predecessor or Old Digimarc's Secure ID Business, they were classified accordingly.

Reasonable allocation. Where the amounts were not clearly or specifically identified, management determined if a reasonable allocation method could be applied. For example, in the shared services human resources ("HR") cost center, management allocated the costs based on the relative headcount of the predecessor and Old Digimarc's Secure ID Business. This allocation was based on the assumption that HR support costs should be relatively equal per employee. In the intellectual property cost center, management allocated the costs based on the relative number of patents that were used by each business.

General allocation approach. For consistency, when specific identification or the reasonable allocation method did not seem to fit the situation, management used a general allocation approach. This approach consisted of a blended rate based on what management determined to be the primary drivers for shared services:

Revenue ratio between the businesses.

Property and equipment balances, which served as a proxy for capital expenditures. The effort expended on capital projects is a factor in the expense and effort of shared services. To avoid fluctuations that occur in capital spending, management believes that these allocated balances represent a relative trend of capital spending between the businesses. In determining the relative balances of property, management excluded the central information technology assets because they supported the entire organization.

Headcount between the businesses.

Other key assumptions differing from the historical accounting of Old Digimarc:

Cash: All cash balances of Old Digimarc are treated as retained by Digimarc, consistent with the Old Digimarc/L-1 merger agreement. Accordingly, restricted cash on the books of Old Digimarc that related directly to its operations flowed through to Digimarc in these financial statements as non-restricted cash included in cash and cash equivalents in the predecessor financial statements. The letters of credit that required the restricted cash remained with Old Digimarc following its acquisition by L-1.

Incentive compensation allocations to cost of services: Cost of incentive compensation related to bonus and stock compensation charges for employees in the research, development and engineering cost centers was not considered significant to Old Digimarc's consolidated

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies (Continued)

operations during the periods reported and were treated as research, development and engineering costs in Old Digimarc's financial statements. For Digimarc's reporting purposes, these incentive compensation costs have been allocated to cost of services to the extent that their pro rata salary allocations were made to the cost of services expense category. The impact for the reported periods ranged from a 1% to 3% reduction in margins compared to the results had the allocations not been made.

Pro-forma earnings (loss) per share (unaudited): The weighted average shares outstanding basic and diluted of 7,143,442 was calculated based on a distribution ratio of one share of Digimarc common stock for every three and one-half shares of Old Digimarc common stock, excluding shares held in treasury, outstanding at August 1, 2008, the date of the spin-off of Digimarc from Old Digimarc.

Stock activity: All stock activity (transactions from stock options, restricted stock, employee stock purchase plan and stock compensation) was carried on the books of Old Digimarc. All net cash from these activities was retained by Digimarc and stock-based compensation expense associated with stock activity was allocated to the predecessor in accordance with the basis of accounting methodology outlined above.

Capital leases: Digimarc shares various infrastructure activities with Old Digimarc and was charged for its allocated share of capital lease costs in the form of allocated depreciation and interest expense. The assets and liabilities associated with the capital leases were carried on the books of Old Digimarc.

Leasehold improvements: Digimarc occupies the majority of Old Digimarc's Beaverton facility and assumed the lease and most all related furniture, fixtures and leasehold improvements when Old Digimarc completed the spin-off of Digimarc. The leasehold was recorded as part of property and equipment on the balance sheet of Digimarc, and as a result, pro rata depreciation and rent expenses were allocated to Old Digimarc.

Intercompany transactions: With the retention by Digimarc of all of Old Digimarc cash, Digimarc's cash balances effectively funded the operations, if needed, of Old Digimarc. The net difference of cash needs for operating and capital expenditures to and from Old Digimarc is shown as "net activity with Parent" in the Statement of Stockholders' Equity. All intercompany transactions were eliminated.

Merger related costs: All Old Digimarc costs related to the Old Digimarc/L-1 merger were allocated to Old Digimarc's Secure ID Business. Digimarc was responsible for the payment of the majority of these costs.

Commitments and contingencies: Commitments and contingencies related to the predecessor operations are included in these financial statements, and those relating to Old Digimarc were excluded.

Stock compensation expense: Stock-based compensation is accounted for by Old Digimarc in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123(R), *Share-Based Payment (Revised 2004)*, which requires the measurement and recognition of compensation

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies (Continued)

for all stock- based awards made to employees and directors, including stock options, employee stock purchases under a stock purchase plan and restricted stock awards based on estimated fair values. Stock compensation expense was allocated to Digimarc based on a combination of specific and shared services resource allocations from Old Digimarc.

The financial information in the predecessor financial statements does not include all of the expenses that would have been incurred had the predecessor been a separate, stand-alone public entity. As such, the predecessor financial information does not reflect the financial position, results of operations and cash flows of Digimarc's current business, had the predecessor operated as a separate, stand-alone public entity during the periods presented in the predecessor financial statements. Additionally, the predecessor financial statements include proportional allocations of various shared services common costs of Old Digimarc because specific identification of these expenses was not practicable. It is expected that the initial operating costs of Digimarc on a stand-alone basis will be higher than those allocated to the predecessor operations under the shared services methodology applied in the predecessor financial statements. Consequently, the financial position, results of operations and cash flows reflected in the predecessor financial statements may not be indicative of those that would have been achieved had the predecessor operated as a separate, stand-alone entity for the periods reflected in the predecessor financial statements.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the U.S. requires Digimarc to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. Certain of the Company's accounting policies require higher degrees of judgment than others in their application. These include revenue recognition on long-term service contracts, impairments and estimation of useful lives of long-lived assets, reserves for uncollectible accounts receivable, contingencies and litigation and stock-based compensation. Digimarc bases its estimates on historical experience and on various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Marketable Securities

The Company considers all investments with original maturities over 90 days that mature in less than one year to be short-term marketable securities. Both short- and long-term marketable securities include federal agency notes, company notes, and commercial paper. The Company's marketable securities are generally classified as held-to-maturity as of the balance sheet date and are reported at amortized cost, which approximates market. The book value of these investments approximates fair market value and, accordingly, no amounts have been recorded to other comprehensive income.

A decline in the market value of any security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount of fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is

DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies (Continued)

other-than-temporary, the Company considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating that the cost of the investment is recoverable outweighs evidence to the contrary. There have been no other-than-temporary impairments identified or recorded by the Company.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using a method that approximates the effective interest method. Under this method, dividend and interest income are recognized when earned.

Fair Value of Financial Instruments

The Company adopted SFAS 157, "*Fair Value Measurements*". SFAS 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and enhances disclosures about fair value measurements. SFAS 157 describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

Level 1 Pricing inputs are quoted prices available in active markets for identical investments as of the reporting date.

Level 2 Pricing inputs are quoted for similar investments, or inputs that are observable, either directly or indirectly, for substantially the full term through corroboration with observable market data. Level 2 includes investments valued at quoted prices adjusted for legal or contractual restrictions specific to these investments.

Level 3 Pricing inputs are unobservable for the investment, that is, inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability. Level 3 includes private portfolio investments that are supported by little or no market activity.

The Company also adopted SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities*." SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for specified financial assets and liabilities on a contract-by-contract basis. The Company did not elect the fair value option under this statement as to specific assets or liabilities. Therefore, through June 30, 2009, the Company has not recognized the net change in fair value of its financial assets and liabilities.

The estimated fair values of the Company's financial instruments, which include cash and cash equivalents, short- and long-term marketable securities, accounts receivable, accounts payable and accrued payroll approximate their carrying values due to the short-term nature of these instruments. The carrying amounts of capital leases approximate fair value because the stated interest rates approximate current market rates. These items are classified as either Level 1 or Level 2 inputs.

The Company records marketable securities at amortized cost of $35,901, which approximates fair value. The fair value of the marketable securities at June 30, 2009, excluding accrued interest, was $35,920. The fair value is based on quoted market prices in active markets for identical assets, a Level 1 input.

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies (Continued)

The Company records money market funds at cost and continues to carry those amounts at cost which equals fair value. The fair value is based on quoted market prices in active markets for identical assets, a Level 1 input. As of June 30,2009, the cost and fair value of the Company's money market funds was equal to $9,580.

Concentrations of Business and Credit Risk

A significant portion of the Company's business depends on a limited number of large contracts. The loss of any large contract may result in loss of revenue and margin on a prospective basis.

Financial instruments that potentially subject Digimarc to concentrations of credit risk consist primarily of cash and cash equivalents, investments, and trade and unbilled accounts receivable. Digimarc places its cash and cash equivalents with major banks and financial institutions and at times deposits may exceed insured limits. Other than cash used for operating needs, which may include short-term investments with our principal banks, our investment policy limits our credit exposure to any one financial institution or type of financial instrument by limiting the maximum of 5% or $1,000, whichever is greater, to be invested in any one issuer except for the U.S. Government and U. S. federal agencies, which have no limits, at the time of purchase. As a result, the credit risk associated with cash and investments is believed to be minimal.

Impairment of Long-Lived Assets

The Company accounts for long-lived assets in accordance with the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by 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 asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Software Development Costs

Under SFAS No. 86, *Accounting for the Cost of Computer Software to Be Sold, Leased, or Otherwise Marketed,* software development costs are to be capitalized beginning when a product's technological feasibility has been established and ending when a product is made available for general release to customers. To date, the establishment of technological feasibility of the Company's products has occurred shortly before general release and, therefore, software development costs qualifying for capitalization have been immaterial. Accordingly, the Company has not capitalized any software development costs and has charged all such costs to research and development expense.

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies (Continued)

Research and Development

Research and development costs are expensed as incurred as defined in SFAS No. 2, *Accounting for Research and Development Costs*. Digimarc accounts for amounts received under its funded research and development arrangements in accordance with the provisions of SFAS No. 68, *Research and Development Arrangements*. Under the terms of the arrangements, Digimarc is not obligated to repay any of the amounts provided by the funding parties. As a result, Digimarc recognizes revenue as the services are performed.

Patent Costs

Costs associated with the application and award of patents in the U.S. and various other countries are capitalized and amortized on a straight-line basis over the term of the patents as determined at award date, which varies depending on the pendency period of the application, generally approximating seventeen years. Capitalized patent costs include internal legal labor, professional legal fees, government filing fees and translation fees related to obtaining the Company's patent portfolio. Such costs were expensed in the predecessor financial statements.

Costs associated with the maintenance and annuity fees of patents are accounted for as prepaid assets at the time of payment and amortized over the respective periods, generally from one to four years. These costs were expensed in the predecessor financial statements.

Revenue Recognition

The Company's revenue consists of subscription revenue, which includes hardware and software sales, royalties and revenues from the licensing of digital watermarking products and related authentication services. The Company's revenue recognition policy follows SEC Staff Accounting Bulletin ("SAB") No. 104 *Revenue Recognition*, SOP No. 97-2, *Software Revenue Recognition*, as amended by SOP No. 98-9, *Modification of SOP No. 97-2, Software Recognition, With Respect to Certain Transactions*, SOP 81-1 *Accounting for the Performance of Construction Type and Certain Production-Type Contracts*, and EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*.

Other income (expense), net

The Company's other income (expense), net consists primarily of interest income earned on cash and short- and long-term investments. Some minor amounts are included in this category that relate to interest expense for capital lease allocations from Old Digimarc and for other non-operating items.

Stock-Based Compensation

The Company adopted SFAS No. 123(R), *Share-Based Payment (Revised 2004)*, which requires the measurement and recognition of compensation for all stock-based awards made to employees and directors including stock options and employee stock purchases under a stock purchase plan based on

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

1. Description of Business and Summary of Significant Accounting Policies (Continued)

estimated fair values. The Company has applied the provisions of SAB 107 in the adoption of SFAS 123(R).

The Company uses the Black-Scholes option pricing model as its method of valuation for stock-based awards. The Company's determination of the fair value of stock-based awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the expected life of the award, our expected stock price volatility over the term of the award and actual and projected exercise behaviors. Although the fair value of stock-based awards is determined in accordance with SFAS 123(R) and SAB 107, the Black-Scholes option pricing model requires the input of highly subjective assumptions, and other reasonable assumptions could provide differing results.

Income Taxes

The Company accounts for income taxes under the asset and liability method. Under the asset and liability method, deferred income taxes reflect the future tax consequences of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce tax assets to the amount expected to be realized.

2. Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value. This statement does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS 157 is effective the first fiscal year beginning after November 15, 2007. The Company has applied the provisions of this standard regarding the framework of measuring fair value and noted no material effect on the current financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* and FSP 157-2, "*Effective Date of FASB Statement No. 157*". FSP 157-1 amends SFAS No. 157 to remove certain leasing transactions from its scope, and was effective upon initial adoption of SFAS 157. FSP 157-2 delayed the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2009. The Company

DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

2. Recent Accounting Pronouncements (Continued)

applied the provisions of FSP 157-2 on non-financial assets and non-financial liabilities and noted no significant impact on our financial statements.

In October 2008, the FASB issued FSP 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*. FSP 157-3 clarifies the application of SFAS 157 in a market that is not active, and addresses application issues such as the use of internal assumptions when relevant observable data does not exist, the use of observable market information when the market is not active, and the use of market quotes when assessing the relevance of observable and unobservable data. FSP 157-3 is effective for all periods presented in accordance with SFAS 157. The adoption of FSP 157-3 did not have a significant impact on our financial statements or the fair values of our financial assets and liabilities.

In April 2009, the FASB issued FSP 157-4: *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*. FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased and identifying circumstances that indicate a transaction is not orderly. The adoption of FSP 157-4 did not have a significant impact on our financial statements or the fair values of our assets or liabilities.

In April 2009, the FASB issued FSP No. 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. FSP 115-2 amends the other-than-temporary impairment guidance in U.S. generally accepted accounting principles (U.S. GAAP) for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. However, it does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The adoption of FSP 115-2 did not have a significant impact on our financial statements or the fair values of our assets or liabilities.

In April 2009, the FASB issued FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. FSP 107-1 expands the fair value disclosures required for all financial instruments within the scope of SFAS No. 107, "*Disclosures about Fair Value of Financial Instruments*," to interim periods for publicly traded entities. The adoption of FSP 107-1 did not have a significant impact on our financial statement disclosures.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*. SFAS 165 establishes general standards of accounting for and disclosure of events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 sets forth the period after the balance sheet date during which we should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which we should recognize events or transactions occurring after the balance sheet date in our financial statements and the disclosures that we should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for interim and annual fiscal periods ending after June 15, 2009. The adoption of SFAS 165 did not have a significant impact on the Company's financial statement disclosures. In preparing the Company's financial statements, the Company evaluated

DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

2. Recent Accounting Pronouncements (Continued)

subsequent events through July 31, 2009, which is the date the Company's quarterly report was filed with the Securities and Exchange Commission.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, is a revision to FASB Interpretation ("FIN") No. 46 (Revised December 2003) ("FIN 46(R)), *Consolidation of Variable Interest Entities*, which changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance. SFAS 167 is effective the first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company does not expect the adoption of this pronouncement will have a material impact on the Company's financial statements.

In June 2009, the FASB issued SFAS No. 168, The "*FASB Accounting Standards Codification* "*and the Hierarchy of Generally Accepted Accounting Principles*. Statement 168 establishes the *FASB Accounting Standards Codification* (Codification) to become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. SFAS 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect the adoption of this pronouncement will have a material impact on the Company's financial statements.

3. Revenue Recognition

Revenue is recognized in accordance with SAB 104 when the following four criteria are met:

(i) persuasive evidence of an arrangement exists;

(ii) delivery has occurred;

(iii) the fee is fixed or determinable; and

(iv) collection is probable.

Some customer arrangements encompass multiple deliverables, such as software, maintenance fees, and software development fees. The Company accounts for these arrangements in accordance with EITF Issue No. 00-21. If the deliverables meet the criteria in EITF Issue No. 00-21, the deliverables are divided into separate units of accounting and revenue is allocated to the deliverables based on their relative fair values. The criteria specified in EITF Issue No. 00-21 are as follows:

(i) the delivered item has value to the customer on a stand-alone basis;

(ii) there is objective and reliable evidence of the fair value of the undelivered item; and

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

3. Revenue Recognition (Continued)

(iii) if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor.

For the Company's purposes, fair value is generally defined as the price at which a customer could purchase each of the elements independently from other vendors or as the price that the Company has sold the element separately to another customer. Management applies judgment to ensure appropriate application of EITF Issue No. 00-21, including value allocation among multiple deliverables, determination of whether undelivered elements are essential to the functionality of delivered elements and timing of revenue recognition, among others.

AICPA SOP No. 98-9 requires that revenue be recognized using the "residual method" in circumstances when vendor specific objective evidence ("VSOE") exists only for undelivered elements. Under the residual method, revenue is recognized as follows: (1) the total fair value of undelivered elements, as indicated by VSOE, is deferred and subsequently recognized in accordance with the relevant sections of AICPA SOP No. 97-2, and (2) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.

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

Revenue from professional service arrangements 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.

Royalty revenue is recognized when the royalty amounts owed to the Company have been earned, are determinable, and collection is probable. Subscriptions are paid in advance and revenue is recognized ratably over the term of the subscription. These revenues include the licensing of digital watermarking products and services for use in authenticating documents, detecting fraudulent documents and deterring unauthorized duplication or alteration of high-value documents, for use in communicating copyright, asset management and business-to-business image commerce solutions, and for use in connecting analog media to a digital environment.

Software revenue is recognized in accordance with AICPA SOP No. 97-2, as amended by AICPA SOP No. 98-9. Revenue for licenses of the Company's software products is recognized upon the Company meeting the following criteria: persuasive evidence of an arrangement exists; delivery has occurred; the vendor's fee is fixed or determinable; and collectibility is probable. Software revenue is recognized over the term of the license or upon delivery and acceptance if the Company grants a perpetual license with no further obligations.

Maintenance revenue is recognized when the maintenance amounts owed to the Company have been earned, are determinable, and collection is probable. Maintenance contracts are, at times,

DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

3. Revenue Recognition (Continued)

paid in advance and revenue is recognized ratably on a straight-line basis over the term of the service period.

The Company records revenue from some customers upon cash receipt as a result of collectibility not being reasonably assured.

Revenue earned which has not been invoiced at the last day of the period, but which are generally billed within one to two weeks of the last day of the period, is included in the balance of trade accounts receivables, net in the balance sheets.

Deferred revenue consists of billings in advance for professional services, subscriptions and hardware for which revenue has not been earned.

4. Segment Information

Geographic Information

The Company derives its revenue from a single reporting segment: media management solutions. Revenue is generated in this segment through licensing of intellectual property, subscriptions to various products and services, and the delivery of services pursuant to contracts with various customers. The Company markets its products in the U.S. and in non-U.S. countries through its sales personnel.

Revenue, based upon the "bill-to" location, by geographic area is as follows:

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008
Domestic	$ 1,777	$ 2,656	$ 3,553	$ 5,314
International	2,547	2,459	5,200	4,886
Total	$ 4,324	$ 5,115	$ 8,753	$ 10,200

Major Customers

Customers who accounted for more than 10% of the Company's revenues are as follows:

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008

Customer A	54%	42%	52%	39%
Customer B	31%	41%	30%	38%

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

5. Stock-Based Compensation

Stock-based compensation includes expense charges for all stock-based awards to employees and directors. These awards include option grants and restricted stock awards.

Stock-based compensation expense was allocated to the predecessor based on a combination of specific and shared services resource allocations from Old Digimarc. All cash flow related to stock compensation generated by Old Digimarc was retained by Digimarc. Stock-based compensation recognized in the three- and six-month periods ended June 30, 2009 is based on the value of the portion of the stock-based award that vested during the period. Compensation cost for all stock-based awards is recognized using the straight-line method.

Determining Fair Value Under SFAS 123(R)

Preferred Stock

The Board of Directors authorized 10,000 shares of Series A Redeemable Nonvoting Preferred stock to be issued to the executive officers. The Series A Redeemable Nonvoting Preferred stock has no voting rights, except as required by law, and may be redeemed by the Board of Directors at any time on or after June 18, 2013.

The fair value of Series A Redeemable Nonvoting Preferred stock is based on the stated fair value of $5.00 per share, and the related stock compensation expense is recognized over the non-redeemable period of 5 years, or 60 months, through June 2013 using the straight-line method.

Stock Options

Valuation and Amortization Method. The Company estimates the fair value of stock-based awards granted using the Black-Scholes option valuation model. The Company amortizes the fair value of all awards on a straight-line basis over the requisite service periods, which are generally the vesting periods. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model.

Expected Life. The expected life of awards granted represents the period of time that they are expected to be outstanding. The Company determined the initial expected life based on a simplified method in accordance with SAB 110, giving consideration to the contractual terms, vesting schedules and pre-vesting and post-vesting forfeitures. Stock options granted generally vest over four years for executive grants and two years for director grants, and have contractual terms of ten years.

Expected Volatility. The Company estimated the initial volatility of its common stock at the date of grant based on an independent analysis of a peer group's historical volatility of their common stock using the Black-Scholes option valuation model based on historical stock prices over the most recent period commensurate with the estimated expected life of the award.

Risk-Free Interest Rate. The Company bases the risk-free interest rate used in the Black-Scholes option valuation model on an interest rate on a Treasury bond with a maturity commensurate with each expected term estimate.

DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

5. Stock-Based Compensation (Continued)

Expected Dividend Yield. The Company has never paid any cash dividends on its common stock and does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model.

Expected Forfeitures. The Company uses a zero forfeiture for both the stock options granted to employees, which vest monthly, and the stock options granted to the Company's Directors, which vest 50% on the first anniversary of the date of grant and then monthly thereafter. The Company records stock-based compensation expense only for those awards that are expected to vest, including awards made to Directors who are expected to continue with the Company through the year following the date of grant. Forfeitures that occur during the month are not expensed.

A summary of the weighted average assumptions and results for options granted during the period August 2, 2008 through June 30, 2009 is as follows:

	Range
Period August 2, 2008 through June 30, 2009:	
Expected life (in years)	5.6 - 6.0
Expected volatility	70% - 72%
Risk-free interest rate	2.8% - 2.9%
Expected dividend yield	0%
Expected forfeiture rate	0%

The estimated average fair value of outstanding stock options was $5.13 at June 30, 2009.

Restricted Stock

The Compensation Committee of the Board of Directors awarded restricted stock shares under the Company's 2008 Stock Incentive Plan to certain employees. The shares subject to the restricted stock awards vest over a certain period, usually four years, following the date of the grant. Specific terms of the restricted stock awards is governed by Restricted Stock Agreements between the Company and the award recipients.

The fair value of restricted stock awards granted is based on the fair market value of the Company's common stock on the date of the grant (measurement date), and is recognized over the vesting period of the related restricted stock using the straight-line method.

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

5. Stock-Based Compensation (Continued)

Stock-based Compensation Under SFAS 123(R)

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008
Stock-based compensation:				
Cost of revenue	$ 50	$ 42	$ 99	$ 85
Sales and marketing	50	93	102	176
Research, development and engineering	49	14	93	30
General and administrative	433	236	839	456
Intellectual property	23	15	46	30
Total stock-based compensation	$ 605	$ 400	$ 1,179	$ 777

At June 30, 2009, the Company had 10,000 Series A Redeemable Nonvoting Preferred stock, 1.0 million non-vested stock options and 133,400 shares of restricted stock outstanding. As of June 30, 2009, the Company had $7.4 million of total unrecognized compensation cost related to non-vested stock-based awards granted under all equity compensation plans, including preferred stock, stock options and restricted stock. Total unrecognized compensation cost will be adjusted for any future changes in estimated forfeitures. The Company expects to recognize this compensation cost for stock options and restricted stock over a weighted average period of 1.68 years and 2.03 years, respectively, through June 2013.

Stock Option Activity

As of June 30, 2009, under all of the Company's stock-based compensation plans, options to purchase an aggregate of 1.2 million shares were outstanding, and options to purchase an additional 1.1 million shares were authorized for future grants under the plans. The Company issues new shares upon option exercises.

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

5. Stock-Based Compensation (Continued)

Options granted, exercised, canceled and expired under the Company's stock option plans are summarized as follows:

Three-months ended June 30, 2009:	**Options**	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life**
Outstanding at March 31, 2009	1,194,000	$ 9.64	
Options granted	30,000	$ 9.91	
Options exercised			
Options canceled or expired			
Outstanding at June 30, 2009	1,224,000	$ 9.65	9.59 years
Exercisable at June 30, 2009	188,161	$ 9.64	9.59 years

Six-months ended June 30, 2009:	**Options**	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life**
Outstanding at December 31, 2008	1,194,000	$ 9.64	
Options granted	30,000	$ 9.91	
Options exercised			
Options canceled or expired			
Outstanding at June 30, 2009	1,224,000	$ 9.65	9.59 years
Exercisable at June 30, 2009	188,161	$ 9.64	9.59 years

The following table summarizes information about stock options outstanding at June 30, 2009:

	Options Outstanding			**Options Exercisable**	
Range of Exercise Prices	**Number Outstanding**	**Remaining Contractual Life (Years)**	**Weighted Average Price**	**Number Exercisable**	**Weighted Average Price**
$9.64	1,194,000	9.58	$ 9.64	185,661	$ 9.64
$9.91	30,000	9.84	$ 9.91	2,500	$ 9.91
$9.64 - $9.91	1,224,000	9.59	$ 9.65	188,161	$ 9.64

At June 30, 2009, the aggregate intrinsic value of outstanding and exercisable stock options was $3,578 and $551, respectively. The aggregate intrinsic value is based on our closing price of $12.57 per share on June 30, 2009, which would have been received by the optionees had all of the options with exercise prices less than $12.57 per share been exercised on that date.

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

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5. Stock-Based Compensation (Continued)

Restricted Stock Activity

The following table details the number of shares granted each period as restricted stock:

Date	Number of Restricted Shares
Period August 2, 2008 through December 31, 2008	136,000
Period January 1, 2009 through March 31, 2009	11,000
Period April 1, 2009 through June 30, 2009	1,400

The following table reconciles the unvested balance of restricted stock:

Three-months ended June 30, 2009:	Number of Shares
Unvested balance, March 31, 2009	132,000
Granted	1,400
Vested	
Canceled	
Unvested balance, June 30, 2009	133,400

Six-months ended June 30, 2009:	Number of Shares
Unvested balance, December 31, 2008	121,000
Granted	12,400
Vested	
Canceled	
Unvested balance, June 30, 2009	133,400

6. Trade Accounts Receivable

Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest.

	Successor June 30, 2009	Successor December 31, 2008
Trade accounts receivable	$ 2,709	$ 3,839
Allowance for doubtful accounts		

Trade accounts receivable, net	$	2,709	$	3,839
Unpaid deferred revenues included in accounts receivable	$	1,127	$	2,155

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

(In thousands, except share and per share data)

(UNAUDITED)

6. Trade Accounts Receivable (Continued)

Allowance for doubtful accounts

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience and current information. The Company reviews its allowance for doubtful accounts monthly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Unpaid deferred revenues

The unpaid deferred revenues that are included in accounts receivable are billed in accordance with the provisions of the contracts with the Company's customers. Unpaid deferred revenues from cash-basis revenue recognition customers are not included in accounts receivable nor deferred revenue accounts.

Major customers

Customers who accounted for more than 10% of accounts receivable, net, are as follows:

	Successor June 30, 2009	Successor December 31, 2008
Customer A	51%	58%
Customer B	43%	27%

7. Property and Equipment

Property and equipment are stated at cost. Property and equipment under capital lease obligations are stated at the lower of the present value of minimum lease payments at the beginning of the lease term or fair value of the leased assets at the inception of the lease. Repairs and maintenance are charged to expense when incurred.

The property and equipment related to the Company were separated from Old Digimarc and recorded at net book value (cost less accumulated depreciation) and classified as used property and equipment.

Depreciation on property and equipment is calculated by the straight-line method over the estimated useful lives of the assets, generally two to seven years. Property and equipment held under capital leases are amortized by the straight-line method over the shorter of the lease term or the

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

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(UNAUDITED)

7. Property and Equipment (Continued)

estimated useful life. Amortization of property and equipment under capital lease is included in depreciation expense.

	Successor June 30, 2009	Successor December 31, 2008
Office furniture fixture	$ 291	$ 291
Equipment	932	793
Leasehold improvements	395	320
	1,618	1,404
Less accumulated depreciation and amortization	(457)	(192)
	$ 1,161	$ 1,212

8. Intangible Assets Purchase and Capitalized Patent Costs

Costs associated with the application and award of patents in the U.S. and various other countries are capitalized and amortized on a straight-line basis over the term of the patents as determined at award date, which varies depending on the pendency period of the application, generally approximating seventeen years. Capitalized patent costs include internal legal labor, professional legal fees, government filing fees and translation fees related to obtaining the Company's patent portfolio.

Costs associated with the maintenance and annuity fees of patents are accounted for as prepaid assets at the time of payment and amortized over the respective periods, generally from one to four years.

Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

	Successor June 30, 2009	Successor December 31, 2008
Gross intangible assets	$ 909	$ 462
Accumulated amortization	(17)	(6)
Intangible assets, net	$ 892	$ 456

9. Income Taxes

Old Digimarc. The provision for income taxes reflects withholding tax expense in various foreign jurisdictions. For all historic periods reported in the financial statements, Old Digimarc maintained valuation allowances against its net deferred tax assets, including net operating loss carry-forwards, because it was not more likely than not that such deferred taxes would be realized. The provision for income taxes included foreign taxes withheld by Old Digimarc's customers and paid to foreign jurisdictions on its behalf. The predecessor financial statements indicate cumulative losses through August 1, 2008.

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

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9. Income Taxes (Continued)

Furthermore, the amounts of cumulative expenses in the financial statements that were not allowed for federal and state income tax purposes were not sufficient to result in positive taxable income which would have required the Company to record income tax expense. As a result, no Federal or state income tax benefit was recognized for the book losses that were incurred in those periods prior to 2007 and no income tax expense was recognized during the 2007 and 2008 periods because any expense was offset by the benefit of net operating loss carry-forwards. Digimarc as a separate legal entity will not benefit from any of the carry-forward tax attributes of Old Digimarc, including net operating loss carry-forwards.

Digimarc. The provision for income taxes reflects withholding tax expense in various foreign jurisdictions. These withholding taxes are computed by our customers and paid to foreign jurisdictions on our behalf. There was no provision for current income taxes related to net income because the computation of taxable income resulted in a net operating loss for the period.

10. Commitments and Contingencies

Certain of the Company's product license and services agreements include an indemnification provision for claims from third parties relating to the Company's intellectual property. Such indemnification provisions are accounted for in accordance with SFAS No. 5, *Accounting for Contingencies*. To date, there have been no claims made under such indemnification provisions.

The Company is subject from time to time to other legal proceedings and claims arising in the ordinary course of business. Although the ultimate outcome of these matters cannot be determined, management believes that, as of June 30, 2009, the final disposition of these proceedings will not have a material adverse effect on the financial position, results of operations, or liquidity of the Company. No accrual has been recorded because the amounts are not probable or reasonably estimatable in accordance with SFAS 5.

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

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(UNAUDITED)

11. Quarterly Financial Information Unaudited

Quarter ended:	Successor March 31	Successor June 30
2009		
Service revenue	$ 2,470	$ 2,585
License and subscription revenue	1,959	1,739
Total revenue	4,429	4,324
Total cost of revenue	1,485	1,528
Gross profit	2,944	2,796
Gross profit percent, service revenue	43%	43%
Gross profit percent, license and subscription revenue	97%	97%
Gross profit percent, total	66%	65%
Sales and marketing	745	728
Research, development and engineering	1,271	1,217
General and administrative	1,688	1,496
Intellectual property	277	217
Transitional services	(60)	(48)
Operating loss	(977)	(814)
Net loss	(809)	(678)
Loss per share:		
Net loss per share basic & diluted	$ (0.11)	$ (0.09)
Weighted average shares outstanding basic and diluted	7,158	7,158

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DIGIMARC CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

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(UNAUDITED)

11. Quarterly Financial Information Unaudited (Continued)

	Predecessor	Predecessor	Predecessor	Successor	Successor
Quarter ended:	**March 31**	**June 30**	**Period July 1 through August 1**	**Period August 2 through September 30**	**December 31**
2008					
Service revenue	$ 2,548	$ 2,987	$ 921	$ 1,645	$ 2,419
License and subscription revenue	2,537	2,128	829	1,536	2,232
Total revenue	5,085	5,115	1,750	3,181	4,651
Total cost of revenue	1,408	1,704	552	934	1,428
Gross profit	3,677	3,411	1,198	2,247	3,223
Gross profit percent, service revenue	47%	45%	43%	46%	44%
Gross profit percent, license and subscription revenue	98%	97%	97%	97%	97%
Gross profit percent, total	72%	67%	69%	71%	69%
Sales and marketing	656	683	589	390	764
Research, development and engineering	922	910	239	780	992
General and administrative	980	927	442	932	1,945
Intellectual property	478	448	176	120	184
Transitional services				(196)	(84)
Operating income (loss)	641	443	(248)	221	(578)
Net income (loss)	924	664	(173)	400	(324)
Earnings (loss) per share:					
Net income (loss) per share basic & diluted				$ 0.06	$ (0.05)
Weighted average shares outstanding basic and diluted				7,143	7,156
Pro-forma earnings (loss) per share:					
Net income (loss) per share basic & diluted	$ 0.13	$ 0.09	$ (0.02)		
Weighted average shares outstanding basic and diluted	7,143	7,143	7,143		

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Item 2. 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 in this Quarterly Report on Form 10-Q under the caption "Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995."

The following discussion should be read in conjunction with our financial statements and the related notes and other financial information appearing elsewhere in this Quarterly Report on Form 10-Q. Readers are also urged to carefully review and consider the disclosures made in Part II, Item 1A (Risk Factors) of this Quarterly Report on Form 10-Q and in the audited financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2008 filed on February 27, 2009, and other reports and filings made with the Securities and Exchange Commission ("SEC").

Unless the context otherwise requires, references in this Quarterly Report on Form 10-Q to (i) "Digimarc," "we," "our" and "us" refer to Digimarc Corporation and (ii) "Old Digimarc" refers to the former Digimarc Corporation, which merged with and into a wholly owned subsidiary of L-1 Identity Solutions, Inc. ("L-1") on August 13, 2008, and its consolidated subsidiaries (other than us).

The Separation of the Digital Watermarking Business from Old Digimarc

On August 1, 2008, Old Digimarc spun off the common stock of Digimarc, which held all of the assets and liabilities of Old Digimarc's Digital Watermarking Business.

Until August 1, 2008, we were a wholly owned subsidiary of DMRC LLC, which immediately prior to the spin-off was a wholly owned subsidiary of Old Digimarc. DMRC LLC was formed in Delaware on June 18, 2008, in anticipation of the spin-off of the Digital Watermarking Business. Prior to the spin-off, in a transaction which we refer to as the restructuring, Old Digimarc contributed all of the assets and liabilities related to its Digital Watermarking Business, together with all of Old Digimarc's cash, including cash received upon the exercise of stock options, to DMRC LLC. The restructuring did not result in the loss of any significant Digital Watermarking Business customers or contracts.

Following the restructuring, all of the limited liability company interests of DMRC LLC were transferred to a newly created trust for the benefit of Old Digimarc record holders on the basis of one limited liability company interest of DMRC LLC for every three and one-half shares of Old Digimarc common stock held by the stockholder as of the spin-off record date and time. DMRC LLC then merged with and into DMRC Corporation, and each limited liability company interest of DMRC LLC was converted into one share of common stock of DMRC Corporation. After completion of the acquisition of Old Digimarc by L-1, DMRC Corporation changed its name to Digimarc Corporation. As a result, upon effectiveness of the Form 10 on October 16, 2008, each Old Digimarc record holder received one share of Digimarc common stock for every three and one-half shares of Old Digimarc common stock held by the stockholder as of the spin-off record date and time, and we became an independent, publicly-traded company owning and operating the Digital Watermarking Business.

Recent Developments Nielsen Joint Venture

On July 1, 2009, we commenced operation of two joint ventures with The Nielsen Company (US) LLC, or Nielsen. In connection with these joint ventures, we terminated our agreement with Nielsen, dated as of October 1, 2007, to enter into the joint venture agreements, and entered into a new patent license agreement. Under the terms of the new patent license agreement, we granted Nielsen a non-exclusive license to Digimarc patents for use within Nielsen's business and Nielsen

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agreed to pay us $18.75 million as follows: $2.0 million for the remainder of 2009; $3.6 million in 2010; $4.0 million in each of 2011, 2012 and 2103; and $1.15 million in 2014.

Under the first joint venture, TVaura LLC, Digimarc and Nielsen will engage in the development of copyright filtering solutions, royalty/audit solutions for online video and audio rights organizations, guilds or other organizations involved in reconciliation of royalties, residuals and other payments, and other related products. Under the second joint venture, TVaura Mobile LLC, Digimarc and Nielsen will engage in the development of certain enhanced television offerings, and other related products. We will provide technical and development services to TVaura LLC's business for the following periods for the following minimum service fees: $1.13 million for the remainder of 2009; $2.80 million in 2010; and $2.74 million in 2011, subject to adjustment for any development service fees paid to Digimarc by TVaura Mobile LLC.

The initial cash contribution of each of Digimarc and Nielsen to TVaura LLC will be an aggregate of $3.9 million payable in quarterly installments from July 2009 through October 2011. The initial cash contribution of each of Digimarc and Nielsen to TVaura Mobile LLC will be an aggregate of $2.8 million payable in quarterly installments from July 2009 through October 2011. Each of Digimarc and Nielsen own approximately half of each joint venture.

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. Our technology provides the means to infuse persistent digital information, perceptible only to computers and digital devices, into all forms of media content. 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 technology, and those of our licensees, span the complete range of media content, enabling our customers and those of our partners to:

- Quickly identify and effectively manage music, movies, television programming, digital images, documents and other printed materials, especially in light of new non-linear distribution over the internet;
- Deter counterfeiting of money, media and goods, and piracy of movies and music;
- Support new digital media distribution models and methods to monetize media content;
- 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;
- 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 authenticate 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 technology 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

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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.

We provide technology-based 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, which we refer to as the Central Banks, and many leading companies in the information technology industry. We and our licensees have successfully propagated digital watermarking in music, movies, television broadcasts, images and printed materials. Digital watermarks 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.

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. We believe we have one of the world's most extensive patent portfolios in the field of digital watermarking and related media enhancement innovations, with over 525 U.S. and foreign patents and more than 410 U.S. and foreign patent applications on file as of June 30, 2009.

Backlog. Based on projected commitments we have for the periods under contract with our respective customers, we anticipate our current contracts as of June 30, 2009 will generate approximately $50 million in revenue during the contractual terms of such contracts, currently up to five years. We expect more than $10 million of this amount to be recognized as revenue during the remainder of 2009.

Some factors that lead to increased backlog include:

- contracts with new customers;
- renewals with current customers;
- add-on orders to current customers; and
- contracts with longer contractual periods replacing contracts with shorter contractual periods.

Some factors that lead to decreased backlog are:

- recognition of revenue associated with backlog currently in place;
- contracts with shorter contractual periods replacing contracts with longer contractual periods; and
- contracts ending with existing customers.

The mix of these factors, among others, dictates whether our backlog increases or decreases for any given period. There is no assurance that our backlog will 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 such realization may change.

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,

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fixed assets, intangible assets, income taxes, long-term service contracts, investments, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions we believe to be reasonable under 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 on long-term service contracts, revenue recognition on license and subscription arrangements, impairments and estimation of useful lives of long-lived assets, contingencies and litigation and stock- based compensation. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements:

Basis of Accounting; Predecessor Financial Statements The predecessor financial statements include certain accounts of Old Digimarc and the assets, liabilities and results of operations of Old Digimarc's Digital Watermarking Business that were separated, or "carved-out," from Old Digimarc. The operating expenses included in the predecessor financial statements include proportional allocations of various shared services common costs of Old Digimarc because specific identification of the expenses was not practicable. The common costs include expenses from Old Digimarc related to various operating shared services cost centers, including: executive, finance and accounting, human resources, legal, marketing, intellectual property, facilities and information technology. Management believes that the assumptions underlying the predecessor financial statements are reasonable. The cost allocation methods applied to certain shared services common cost centers include the following:

Specific identification. Where the amounts were specifically identified to the predecessor or Old Digimarc's Secure ID Business, they were classified accordingly.

Reasonable allocation. Where the amounts were not clearly or specifically identified, we determined if a reasonable allocation method could be applied. For example, in the shared services human resources ("HR") cost center we allocated the costs based on the relative headcount of the predecessor and Old Digimarc's Secure ID Business. This allocation was based on the assumption that HR support costs should be relatively equal per employee. In the intellectual property cost center we allocated the costs based on the relative number of patents that were used by each business.

General allocation approach. For consistency, when specific identification or a reasonable allocation method did not seem to fit the situation, we used a general allocation approach. This approach consisted of a blended rate based on what we determined to be the primary drivers for shared services:

Revenue ratio between the businesses.

Property and equipment balances, which served as a proxy for capital expenditures. The effort expended on capital projects is a factor in the expense and effort of shared services. To avoid fluctuations that occur in capital spending, we believe that these allocated balances represent a relative trend of capital spending between the businesses. In determining the relative balances of property, we excluded the central information technology assets because they supported the entire organization.

Headcount between the businesses.

Other key assumptions differing from the historical accounting of Old Digimarc:

Cash: All cash balances of Old Digimarc are treated as retained by Digimarc, consistent with the Old Digimarc/L-1 merger agreement. Accordingly, restricted cash on the books of Old Digimarc that related directly to its operations flowed through to Digimarc in these financial

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statements as non-restricted cash included in cash and cash equivalents in the predecessor financial statements. The letters of credit that required the restricted cash remained with Old Digimarc following its acquisition by L-1.

Incentive compensation allocations to cost of services: Cost of incentive compensation related to bonus and stock compensation charges for employees in the research, development and engineering cost centers was not considered significant to Old Digimarc's consolidated operations during the periods reported and were treated as research, development and engineering costs in Old Digimarc's financial statements. For Digimarc's reporting purposes, these incentive compensation costs have been allocated to cost of services to the extent that their pro rata salary allocations were made to the cost of services expense category. The impact for the reported periods ranged from a 1% to 3% reduction in margins compared to the results had the allocations not been made.

Pro-forma earnings (loss) per share (unaudited): The weighted average shares outstanding basic and diluted of 7,143,442 was calculated based on a distribution ratio of one share of Digimarc common stock for every three and one-half shares of Old Digimarc common stock, excluding shares held in treasury, outstanding at August 1, 2008, the date of the spin-off of Digimarc from Old Digimarc.

Stock activity: All stock activity (transactions from stock options, restricted stock, employee stock purchase plan and stock compensation) was carried on the books of Old Digimarc. All net cash from these activities was retained by Digimarc and stock-based compensation expense associated with stock activity was allocated to the predecessor in accordance with the basis of accounting methodology outlined above.

Capital leases: Digimarc shares various infrastructure activities with Old Digimarc and was charged for its allocated share of capital lease costs in the form of allocated depreciation and interest expense. The assets and liabilities associated with the capital leases were carried on the books of Old Digimarc.

Leasehold improvements: Digimarc occupies the majority of Old Digimarc's Beaverton facility and assumed the lease and most all related furniture, fixtures and leasehold improvements when Old Digimarc completed the spin-off of Digimarc. The leasehold was recorded as part of property and equipment on the balance sheet of Digimarc, and as a result, pro rata depreciation and rent expenses were allocated to Old Digimarc.

Intercompany transactions: With the retention by Digimarc of all of Old Digimarc cash, Digimarc's cash balances effectively funded the operations, if needed, of Old Digimarc. The net difference of cash needs for operating and capital expenditures to and from Old Digimarc is shown as "net activity with Parent" in the Statement of Stockholders' Equity. All intercompany transactions were eliminated.

Merger related costs: All Old Digimarc costs related to the Old Digimarc/L-1 merger were allocated to Old Digimarc's Secure ID Business. Digimarc was responsible for payment of the majority of these costs

Commitments and contingencies: Commitments and contingencies related to the predecessor operations are included in these financial statements, and those relating to Old Digimarc were excluded.

Stock compensation expense: Stock-based compensation is accounted for by Old Digimarc in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123(R), *Share-Based Payment (Revised 2004)*, which requires the measurement and recognition of compensation for all stock- based awards made to employees and directors, including stock options, employee

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stock purchases under a stock purchase plan and restricted stock awards based on estimated fair values. Stock compensation expense was allocated to Digimarc based on a combination of specific and shared services resource allocations from Old Digimarc.

The financial information in the predecessor financial statements does not include all of the expenses that would have been incurred had the predecessor been a separate, stand-alone public entity. As such, the predecessor financial information does not reflect the financial position, results of operations and cash flows of Digimarc's current business had the predecessor operated as a separate, stand-alone public entity during the periods presented in the predecessor financial statements. Additionally, the predecessor financial statements include proportional allocations of various shared services common costs of Old Digimarc because specific identification of these expenses was not practicable. It is expected that the initial operating costs of Digimarc on a stand-alone basis will be higher than those allocated to the predecessor operations under the shared services methodology applied in the predecessor financial statements. Consequently, the financial position, results of operations and cash flows reflected in the predecessor financial statements may not be indicative of those that would have been achieved had the predecessor operated as a separate, stand-alone entity for the periods reflected in the predecessor financial statements.

Revenue recognition: Some customer arrangements encompass multiple deliverables, such as software, hardware sales, consumables sales, maintenance fees, and software development fees. We account for these arrangements in accordance with Emerging Issues Task Force ("EITF") Issue No. 00-21. If the deliverables meet the criteria in EITF Issue No. 00-21, the deliverables are divided into separate units of accounting and revenue is allocated to the deliverables based on their relative fair values. The criteria specified in EITF Issue No. 00-21 are as follows:

(i) the delivered item has value to the customer on a stand-alone basis;

(ii) there is objective and reliable evidence of the fair value of the undelivered item; and

(iii) if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor.

For our purposes, fair value is generally defined as the price at which a customer could purchase each of the elements independently from other vendors or as the price that we have sold the element separately to another customer. Management applies judgment to ensure appropriate application of EITF Issue No. 00-21, including value allocation among multiple deliverables, determination of whether undelivered elements are essential to the functionality of delivered elements and timing of revenue recognition, among others. Revenue is recognized in accordance with SAB 104 when the following four criteria are met:

(i) persuasive evidence of an arrangement exists;

(ii) delivery has occurred;

(iii) the fee is fixed or determinable; and

(iv) collection is probable.

AICPA SOP No. 98-9 requires that revenue be recognized using the "residual method" in circumstances when vendor specific objective evidence ("VSOE") exists only for undelivered elements. Under the residual method, revenue is recognized as follows: (1) the total fair value of undelivered elements, as indicated by VSOE, is deferred and subsequently recognized in accordance with the relevant sections of AICPA SOP No. 97-2, and (2) the difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements.

Revenue recognition on long-term service contracts: Revenue from professional service arrangements is generally determined based on time and materials or a cost plus a profit margin measure. Revenue for professional services is recognized as the services are performed. Losses on contracts, if any, are provided for in the period in which the loss becomes determinable. Invoicing for services rendered generally occurs within one to two weeks after each month end that the services are provided. Revenue earned which has not been invoiced at the last day of the period is included in the balance of trade receivables, net in the balance sheets.

Revenue recognition on license and subscription arrangements: Royalty revenue is recognized when the royalty amounts owed to Digimarc have been earned, are determinable, and collection is probable. These revenues are earned through the licensing of digital watermarking products and services for use in:

- authenticating documents;
- detecting fraudulent documents and deterring unauthorized duplication or alteration of high-value documents;
- communicating copyright, asset management and business-to-business image commerce solutions; and
- connecting analog media to a digital environment.

Licensing and subscription revenues are paid in advance and recognized ratably over the term of the license or subscription period.

Impairments and estimation of useful lives of long-lived assets: We periodically 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 SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by 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 asset. Also, we periodically review the useful lives of long-lived assets whenever events or changes in circumstances indicate that the useful life may have changed. If the estimated useful lives of such assets do change, we adjust the depreciation or amortization period to a shorter or longer period, based on the circumstances identified.

Contingencies and litigation: We periodically 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 SFAS No. 5, *Accounting for 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 such 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 SFAS 5 are not met, but the probability of an adverse outcome is at least reasonably possible, we will disclose the nature of the contingency

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and provide an estimate of the possible loss or range of loss, or state that such an estimate cannot be made.

Patent Costs: Costs associated with the application and award of patents in the U.S. and various other countries are capitalized and amortized on a straight-line basis over the term of the patents as determined at award date, which varies depending on the pendency period of the application, generally approximating seventeen years. Capitalized patent costs include internal legal labor, professional legal fees, government filing fees and translation fees related to obtaining the Company's patent portfolio. These costs were expensed in the predecessor financial statements.

Costs associated with the maintenance and annuity fees of patents are accounted for as prepaid assets at the time of payment and amortized over the respective periods, generally from one to four years. These costs were expensed in the predecessor financial statements.

Stock-based compensation: We account for stock-based compensation in accordance with SFAS No. 123(R), *Share-Based Payment (Revised 2004)*, which requires the measurement and recognition of compensation for all stock- based awards made to employees and directors including stock options and employee stock purchases under a stock purchase plan based on estimated fair values. We use the Black-Scholes option pricing model as our method of valuation for stock- based awards. Our determination of the fair value of stock-based awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited, to the expected life of the award, our expected stock price, volatility over the term of the award and actual and projected exercise behaviors. Although the fair value of stock-based awards is determined in accordance with SFAS 123(R), the Black-Scholes option pricing model requires the input of highly subjective assumptions, and other reasonable assumptions could provide differing results. The fair value of restricted stock awards granted is based on the fair market value of our common stock on the date of the grant (measurement date), and is being recognized over the vesting period of the related restricted stock using the straight-line method.

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Results of Operations

The following table presents our statements of operations data for the periods indicated as a percentage of total revenue. Unless otherwise indicated, all references to the three- and six-month periods relate to the three- and six-month periods ended June 30, 2009 and all changes discussed with respect to the period reflect changes compared to the three- and six-month periods ended June 30, 2008.

	Successor Three Months Ended June 30, 2009	**Predecessor Three Months Ended June 30, 2008**	**Successor Six Months Ended June 30, 2009**	**Predecessor Six Months Ended June 30, 2008**
Revenue:				
Service	60%	58%	58%	54%
License and subscription	40	42	42	46
Total revenue	100	100	100	100
Cost of revenue:				
Service	34	32	33	29
License and subscription	1	1	1	1
Total cost of revenue	35	33	34	30
Gross profit	65	67	66	70
Operating expenses:				
Sales and marketing	17	13	17	13
Research, development and engineering	28	18	28	18
General and administrative	35	18	36	19
Intellectual property	5	9	6	9
Transitional services	(1)		(1)	
Total operating expenses	84	58	86	59
Operating income (loss)	(19)	9	(20)	11
Other income (expense), net	3	4	3	5
Income (loss) before provision for income taxes	(16)	13	(17)	16
Provision for income taxes				
Net income (loss)	(16)%	13%	(17)%	16%

Our revenue for the three- and six-month periods ended June 30, 2009 decreased 15% to $4.3 million from $5.1 million and 14% to $8.8 million from $10.2 million, respectively, for the prior year periods. The decreases were primarily the result of lower license and royalty revenues from a few of our customers based on a combination of contractual revenue, lower royalty reporting from our licensees whose revenues were slightly lower and receipt of cash from our cash basis customers whose revenues are non-linear in nature, offset in part by increased project work from the consortium of central banks. In addition, as further discussed below, we incurred higher operating expenses for the period during which we operated as a stand-alone company.

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Revenue

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Decrease	Percent Decrease	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008	Dollar Decrease	Percent Decrease
	(in thousands)							
Revenue:								
Service	$ 2,585	$ 2,987	$ (402)	(13)%	$ 5,055	$ 5,535	$ (480)	(9)%
License and subscription	1,739	2,128	(389)	(18)%	3,698	4,665	(967)	(21)%
Total	$ 4,324	$ 5,115	$ (791)	(15)%	$ 8,753	$ 10,200	$ (1,447)	(14)%
Revenue (as % of total revenue):								
Service	60%	58%			58%	54%		
License and subscription	40%	42%			42%	46%		
Total	100%	100%			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, or fixed price consulting agreements. The majority of our services revenue is derived from contracts with an international consortium of Central Banks, Nielsen, and other government agencies. The agreements can 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, for cost reimbursement for third party costs and services. The increases or decreases in the services 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 needs of the customers arise. 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 other government agencies are generally shorter term in nature, are less linear in billings and less predictable than our longer terms contracts since they are subject to government budgets and funding.

The decrease in service revenue for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, were due primarily to lower consulting revenues from Nielsen where we were engaged at an accelerated level of services in the initial year of the contract, and government contract revenues that are non-linear in nature, offset in part by increased revenue from additional program work from the Central Banks.

License and subscription. License revenue originates primarily from licensing our technology and patents where we receive royalties as our income stream. Subscription revenue consists primarily of royalty revenue from the sale of our web-based subscriptions related to various software products, which are more recurring in nature. Revenues from our licensed products have minimal associated direct costs, and thus are highly profitable.

The decrease in license and subscription revenue for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, were due primarily to lower license revenue from Nielsen in accordance with contractual terms, and lower royalty reporting and receipt of cash from our cash basis customers.

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Revenue by Geography

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Increase (Decrease)	Percent Increase (Decrease)	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008	Dollar Increase (Decrease)	Percent Increase (Decrease)
				(in thousands)				
Revenue by geography:								
Domestic	$ 1,777	$ 2,656	$ (879)	(33)%	$ 3,553	$ 5,314	$ (1,761)	(33)%
International	2,547	2,459	88	4%	5,200	4,886	314	6%
Total	$ 4,324	$ 5,115	$ (791)	(15)%	$ 8,753	$ 10,200	$ (1,447)	(14)%
Revenue (as % of total revenue):								
Domestic	41%	52%			41%	52%		
International	59%	48%			59%	48%		
Total	100%	100%			100%	100%		

Domestic revenue decreased for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, due primarily to lower revenues from Nielsen, and to a lesser extent lower revenues from our government contracts and our royalty reporting licensees.

International revenue slightly increased for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, due primarily to increased revenue from the Central Banks, offset by lower revenues from our royalty reporting licensees.

Cost of Revenue

Service. Cost of service revenue primarily includes costs that are allocated from research, development, engineering and sales and marketing that relate directly to producing revenue under our customer contracts, and, to a lesser extent, direct costs of program delivery for both personnel and operating expenses. Allocated costs include:

- salaries, a payroll tax and benefit factor, incentive 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 the customer;
- depreciation charges for machinery, equipment and software; and
- travel costs directly attributable to service and development contracts.

License and subscription. Cost of license and subscription revenue primarily includes:

patent or software license costs for any patents licensed from third parties where the party receives a portion of royalties or license revenue received by Digimarc; and

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

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Gross Profit

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Decrease	Percent Decrease	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008	Dollar Decrease	Percent Decrease
				(in thousands)				
Gross Profit:								
Service	$ 1,105	$ 1,344	$ (239)	(18)%	$ 2,158	$ 2,543	$ (385)	(15)%
License and subscription	1,691	2,067	(376)	(18)%	3,582	4,545	(963)	(21)%
Total	$ 2,796	$ 3,411	$ (615)	(18)%	$ 5,740	$ 7,088	$ (1,348)	(19)%
Gross Profit (as % of related revenue components):								
Service	43%	45%			43%	46%		
License and subscription	97%	97%			97%	97%		
Total	65%	67%			66%	70%		

The decrease in gross profit dollars primarily reflect the impact of variations in scheduled payments in certain of our long-term contracts; a continued deferral of work on previously announced appropriations for federal defense projects; and to a lesser extent, lower royalties from some patent and technology licenses. The decrease in gross profit as a percentage of revenue for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, were due primarily to:

revenue mix resulting in lower license revenue, as a percent of total revenue, which carries a higher margin than service revenue; and

higher expenses for the period during which we operated as a stand-alone company compared to the shared services allocation methodology applied in the predecessor financial statements.

Operating Expenses

The financial information in the predecessor financial statements does not include all of the expenses that would have been incurred had the predecessor operated as a separate, stand-alone public entity. As such, the predecessor financial information does not reflect the operating expenses of Digimarc's current business had the predecessor been a separate, stand-alone public entity during the periods presented in the predecessor's financial statements. Additionally, the predecessor financial statements include proportional allocations of various shared services common costs of Old Digimarc because specific identification of these expenses was not practicable. It is expected that the initial operating costs of Digimarc on a stand-alone basis will be higher than those allocated to the predecessor operations under the shared services methodology applied in the predecessor financial statements. Consequently, the operating expenses reflected in the predecessor financial statements may not be indicative of those that would have been achieved had the predecessor operated as a separate, stand-alone entity for the periods reflected in the predecessor financial statements. The operating expenses for the three- and six-month periods ended June 30, 2009 are in-line with our expectations as a stand-alone entity.

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Sales and marketing

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Increase	Percent Increase	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008	Dollar Increase	Percent Increase
				(in thousands)				
Sales and marketing	$ 728	$ 683	$ 45	7%	$ 1,473	$ 1,339	$ 134	10%
Sales and marketing (as % of total revenue)	17%	13%			17%	13%		

Sales and marketing expenses consist primarily of:

- compensation, benefits and related costs of sales and marketing employees and product managers;
- travel and market research costs, and costs associated with marketing programs, such as trade shows, public relations and new product launches;
- incentive compensation in the form of bonuses and stock-based compensation expense; and
- charges for infrastructure and centralized costs of facilities and information technology.

We allocate certain costs of sales and marketing to cost of service revenue when they relate directly to our service contracts. For direct billable labor hours, we allocate to cost of service revenue:

- salaries;
- a payroll tax and benefits factor; and
- incentive compensation related to our bonus and stock compensation plans.

We record all remaining, or "residual," costs as sales and marketing costs.

The increases in sales and marketing expense for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, resulted primarily from higher expenses for the period during which we operated as a stand-alone company compared to the shared services allocation methodology applied in the predecessor financial statements.

We anticipate that we will continue to incur sales and marketing costs at higher levels to support ongoing sales initiatives.

Research, development and engineering

Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Increase	Percent Increase	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008	Dollar Increase	Percent Increase

	(in thousands)												
Research, development and engineering	$	1,217	$	910	$	307	34%	$	2,488	$	1,832	$	656	36%
Research, development and engineering (as % of total revenue)		28%		18%					28%		18%			

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Research, development and engineering expenses arise primarily from three areas that support our business model:

Fundamental Research:

- Investigation of new watermarking algorithms to increase robustness and/or computational efficiency;
- Mobile device usage models and imaging sub-systems in camera-phones;
- Industry conference participation and authorship of papers for industry journals;
- Development of new intellectual property, including documentation of claims and production of supporting diagrams and materials;
- Video watermarking research focused on low-bit rate video applications; and
- Research in fingerprinting and other content identification technologies.

Platform Development:

- Continued development and porting to different operating systems of the Digimarc Global Software Development Kit, or SDK (DGSDK), which packages the core image watermarking algorithms for Print & Imaging applications;
- Development and support of the Geo-Spatial SDK (GEOSDK) for geospatial imaging applications;
- Tuning and optimization of implementation models to improve resistance to non-malicious attacks and routine transformations, such as JPEG, cropping and printing; and
- Creation of a platform to encapsulate fixed point watermarking algorithms, optimized for mobile devices.

Product Development:

- Migration of applications to new platforms, specifically linking Digimarc for Images (formerly known as ImageBridge) to DGSDK and Digimarc Mobile;
- Updating Digimarc for Images Plug-Ins for Photoshop CS4, including new interfaces and translation into 27 languages;
- Porting of Digimarc for Images SDK and related applications such as the Digimarc for Images Reader to various operating systems, including Vista, Linux & OS X;

- Development of Digimarc Mobile reader prototype for new mobile devices; and
- Prototype UGC site ingest, queue, and content management system to demonstrate potential applications of digital watermarking.

Research, development and engineering expenses consist primarily of:

- compensation, benefits and related costs of software developers and quality assurance personnel;
- payments to outside contractors;
- the purchase of materials and services for product development;
- incentive compensation in the form of bonuses and stock-based compensation expense; and
- charges for infrastructure and centralized costs of facilities and information technology.

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We allocate certain costs of research, development and engineering to cost of service revenue when they relate directly to our service contracts. For direct billable labor hours, we allocate to cost of service revenue:

- salaries;
- a payroll tax and benefits factor; and
- incentive compensation related to our bonus and stock compensation plans.

We record all remaining, or "residual," costs as research, development and engineering costs.

The increases in research, development and engineering expense for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, resulted primarily from:

- increased headcount and employee compensation-related expenses from hiring additional engineers and scientists to facilitate expected growth in service revenue and to increase our investment in research and development; and
- higher expenses for the period during which we operated as a stand-alone company compared to the shared services allocation methodology applied in the predecessor financial statements.

We anticipate that we will continue to invest in research, development and engineering expenses at existing or higher levels in the near term to support certain ongoing product initiatives and service contracts, and expect to moderate spending in the longer term.

General and administrative

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Increase	Percent Increase	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008	Dollar Increase	Percent Increase
	(in thousands)							
General and administrative	$ 1,496	$ 927	$ 569	61%	$ 3,184	$ 1,907	$ 1,277	67%
General and administrative (as % of total revenue)	35%	18%			36%	19%		

We incur general and administrative costs in the functional areas of finance, legal, human resources, executive and board of directors. Costs for facilities and information technology are also managed as part of the general and administrative processes and are allocated to this area as well as each of the areas in costs of services, sales and marketing, and research development and engineering. General and administrative expenses consist primarily of:

- compensation, benefits and related costs;
- third party and professional fees associated with legal, accounting, human resources and costs associated with being a public company;

- incentive compensation in the form of bonuses and stock-based compensation expense; and

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

The increases in general and administrative expenses for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008,

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resulted primarily from higher expenses for the period during which we operated as a stand-alone company compared to the shared services allocation methodology applied in the predecessor financial statements.

We anticipate that we will continue to incur general and administrative expenses at least at existing levels, while continuing to examine means to reduce general and administrative expenses as a percentage of revenue in the longer term.

Intellectual property

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Decrease	Percent Decrease	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended March 31, 2008	Dollar Decrease	Percent Decrease
				(in thousands)				
Intellectual property	$ 217	$ 448	$ (231)	(52)%	$ 494	$ 926	$ (432)	(47)%
Intellectual property (as % of total revenue)	5%	9%			6%	9%		

We incur intellectual property expenses that arise primarily from costs associated with documenting, applying for, and maintaining domestic and international patents and trademarks:

Gross expenditures for intellectual property costs, before reflecting the effect of capitalized patent costs, primarily consist of:

- compensation, benefits and related costs of attorneys and legal assistants;
- third party costs including filing and governmental regulatory fees and fees for outside legal counsel and translation costs, each incurred in the patent process;
- incentive compensation in the form of bonuses and stock-based compensation expense; and
- charges for infrastructure and centralized costs of facilities and information technology.

Prior to August 2, 2008, the predecessor accounted for gross expenditures for intellectual property costs as expenses. On August 2, 2008 we began capitalizing patent application and award costs.

The decreases in intellectual property expenses for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, resulted primarily from capitalized patent application and award costs aggregating $0.3 million and $0.5 million, respectively.

We anticipate that we will continue to invest in intellectual property expenses at current levels or higher.

Transitional services

In connection with the sale of Old Digimarc's Secure ID Business and the spin-off of the Digital Watermarking Business, Old Digimarc and Digimarc entered into a transition services agreement to provide one another with transition services and other assistance substantially consistent with the services provided before the spin-off.

To enable Old Digimarc to continue its operation of the Secure ID Business and facilitate the effective transition of the Digital Watermarking Business to Digimarc, under the transition services

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agreement Old Digimarc provides the following services or support to Digimarc: information technology services and legal services. Similarly, Digimarc provides the following services or support to Old Digimarc: accounting and tax services, information technology services, legal services, human resource services and facilities.

The fees for the transition services generally are intended to cover each party's reasonable costs incurred in connection with providing the transition services. Hourly rates for personnel performing transition services were determined based on fully loaded costs, taking into account base pay, a bonus based on obtaining target earnings, payroll taxes, benefit costs, a pro rata portion of overhead charges paid by Old Digimarc or Digimarc, as applicable, and the current year stock compensation charge for the individual, divided by the total hours available for the employee for the year, taking into account the need for administrative time.

The net transitional services expenses reimbursed to Digimarc aggregated $0.1 million for the three- and six-month periods ended June 30, 2009 and are expected to decline through the end of the year 2009 as the amount of transition services decline.

Stock-based compensation.

	Successor Three Months Ended June 30, 2009	**Successor Three Months Ended June 30, 2008**	**Dollar Increase (Decrease)**	**Percent Increase (Decrease)**	**Successor Six Months Ended June 30, 2009**	**Predecessor Six Months Ended June 30, 2008**	**Dollar Increase (Decrease)**	**Percent Increase (Decrease)**
				(in thousands)				
Cost of revenue	$ 50	$ 42	$ 8	19%	$ 99	$ 85	$ 14	16%
Sales and marketing	50	93	(43)	(46)%	102	176	(74)	(42)%
Research, development and engineering	49	14	35	250%	93	30	63	210%
General and administrative	433	236	197	83%	839	456	383	84%
Intellectual property	23	15	8	53%	46	30	16	53%
Total	$ 605	$ 400	$ 205	51%	$ 1,179	$ 777	$ 402	52%

Old Digimarc accounted for stock-based compensation in accordance with SFAS 123(R), which requires the measurement and recognition of compensation for all stock- based awards made to employees and directors, including stock options, employee stock purchases under a stock purchase plan and restricted stock awards based on estimated fair values. Stock compensation expense was allocated to the predecessor based on a combination of specific and shared services resource allocations from Old Digimarc.

The increases in stock-based compensation expense for the three- and six-month periods ended June 30, 2009, compared to the corresponding three-and six-month periods ended June 30, 2008, resulted primarily from Digimarc applying SFAS 123R with respect to our initial stock-based awards compared to the shared services allocation methodology applied in the predecessor financial statements.

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Other income, net

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Decrease	Percent Decrease	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008	Dollar Decrease	Percent Decrease
				(in thousands)				
Other income, net	$ 140	$ 221	$ (81)	(37)%	$ 313	$ 515	$ (202)	(39)%

Other income, net consists primarily of interest income from our cash and short- and long-term marketable securities.

The decreases in other income, net for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, resulted primarily from lower interest earned on cash and investment balances, reflecting lower interest rates paid on these balances.

Provision for Income Taxes.

Old Digimarc. The provision for income taxes reflects expected tax expense from profitability in certain foreign jurisdictions. The predecessor recorded a full valuation allowance against net deferred tax assets at August 1, 2008 due to the uncertainty of realization of net operating losses. As a separate legal entity, we will not benefit from any of the carry-forward tax attributes of Old Digimarc, including net operating loss carry-forwards.

Digimarc. There was no provision for income taxes of Digimarc, other than foreign withholding taxes, for the three- and six-month period ended June 30, 2009 since the estimated effective tax rate for the period ending December 31, 2009 is expected to be zero.

Liquidity and Capital Resources

	Successor June 30, 2009	Successor December 31, 2008
	(in thousands)	
Working capital	$ 43,770	$ 41,099
Current (liquidity) ratio (1)	14.4:1	11.9:1
Cash, cash equivalents and short-term marketable securities	$ 43,401	$ 40,168
Long-term marketable securities	$ 2,087	$ 5,744
Total cash, cash equivalents and all marketable securities	$ 45,488	$ 45,912

(1) The current (liquidity) ratio is calculated by taking total current assets divided total current liabilities.

The $2.7 million increase in working capital resulted primarily from the maturity of some of our long-term investments, offset by investments in our business for both capital and intellectual property initiatives.

Operating Cash Flow. The components of operating cash flows were:

	Successor Six Months Ended June 30, 2009	Predecessor Six Months Ended June 30, 2008	Dollar Increase (Decrease)	Percent Increase (Decrease)
		(in thousands)		
Net income (loss)	$ (1,487)	$ 1,588	$ (3,075)	(194)%
Non-cash items	1,455	1,223	232	19%
Changes in operating assets and liabilities	277	67	210	313%

Net cash provided by (used in) operating activities	$	245	$	2,878	$	(2,633)	(91)%

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Net income (loss). The decrease in operating results primarily reflects lower revenues and higher expenses for the period during which we operated as a stand-alone company compared to the benefits received from the shared services cost allocation methodology in the predecessor financial statements.

Non-cash charges. The increase in non-cash charges was primarily the result of the shared services allocation methodology applied in the predecessor financial statements to both depreciation of property and equipment and stock compensation.

Operating assets and liabilities.

The primary changes in the operating assets and liabilities for the six-month period ended June 30, 2009 relate to:

- collection of advanced billings, as provided in our contracts with customers; offset by
- the amortization of deferred revenues.

The primary changes in the operating assets and liabilities for the six-month period ended June 30, 2008 relate to:

- the timing and mix of service revenues, which generally carry a longer collection period than license revenues;
- the billings for revenues that are made in advance, as provided in our contracts with customers, and the related collections of receivables, result in deferred revenues, the timing of which fluctuates and can change from period to period based on individual customer requirements; and
- the accrual for and payment of liabilities related to payroll and related costs, such as our 401(k) plan matching contributions. This cost and associated liability were traditionally accrued each month and increase throughout each year and then paid out to participants in the first quarter after each year end. For 2009, the matching contributions are paid out after each payroll.

Cash flows from investing activities. The primary changes in our investing activities for the six-month periods ended June 30, 2009 and 2008 relate to:

- investments made in property and equipment, primarily in our information technology area for computer systems and related equipment used to operate our business;
- investments made in the patent application and granting process; and
- net activity from investing our cash and cash equivalents and short- and long-term marketable securities.

Cash flows from financing activities. While there were no major financing activities for the six-month period ended June 30, 2009, the major changes for the six-month period ended June 30, 2008 were the result of cash transactions associated with Old Digimarc in accordance with the basis of accounting used in our financial statements. Specifically,

- all cash received from Old Digimarc's stock activity, primarily from the exercise of stock options, flows through to Digimarc; and
- all cash flow generated or used by Old Digimarc flowed into or out of Digimarc.

Future Cash Expectations.

We believe that our current cash, cash equivalents, and short-term investment balances will satisfy our projected working capital and capital expenditure requirements for at least the next 12 months. Thereafter, we anticipate continuing to use cash, cash equivalents and short-term investment balances to satisfy our projected working capital and capital expenditure requirements.

We may utilize cash resources to fund acquisitions or investments in complementary businesses, technologies or product lines. In order to take advantage of opportunities, we may find it necessary to obtain additional equity financing, debt financing, or credit facilities. We do not believe at this time, however, that our long-term working capital and capital expenditures would require us to take steps to remedy any such potential deficiencies. If it were necessary to obtain additional financings or credit facilities, we may not be able to do so, or if these funds are available, they may not be available on satisfactory terms.

Contractual Obligations

Pursuant to the terms of the joint venture agreements with Nielsen, the Company will be contributing $6.7 million to the joint ventures paid in quarterly installments of $0.7 million from July 2009 through October 2011.

Our significant commitments consist of obligations under non-cancelable operating leases for our facilities, rent and various equipment leases, which totaled $1.9 million as of June 30, 2009 and are payable in monthly installments through February 2013. Other than as described above, as of June 30, 2009, there have been no material changes in the contractual obligations disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008.

Adjusted EBITDA

We define Adjusted EBITDA as net earnings before interest expense, income taxes, depreciation, amortization and non-cash expenditures for stock compensation. Adjusted EBITDA is not a measure of financial performance under generally accepted accounting principles. Management uses Adjusted EBITDA in internal analyses as a supplemental measure of our financial performance to assist it in determining performance comparisons against its peer group of companies, as well as capital spending and other investing decisions. Adjusted EBITDA is also a common alternative measure of performance used by investors, financial analysts, and rating agencies to evaluate financial performance. Adjusted EBITDA should not be considered in isolation or as a substitute for net earnings, operating income, cash flows provided by operating activities or other income or cash flow data prepared in accordance with U.S. GAAP and this non-GAAP measure may not be comparable to similarly titled measures of other companies.

The following table presents a reconciliation of Adjusted EBITDA to net earnings:

	Successor Three Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Increase (Decrease)	Percent Increase (Decrease)	Successor Six Months Ended June 30, 2009	Predecessor Three Months Ended June 30, 2008	Dollar Increase (Decrease)	Percent Increase (Decrease)
				(in thousands)				
Net income (loss)	$ (678)	$ 664	$ (1,342)	(202)%	$ (1,487)	$ 1,588	$ (3,075)	(194)%
Adjustments:								
Provision for income taxes	4		4	100%	9	11	(2)	(18)%
Interest income, net	(137)	(221)	84	(38)%	(312)	(515)	203	39%
Depreciation and amortization	141	170	(29)	(17)%	276	446	(170)	(38)%
Stock compensation	605	400	205	51%	1,179	777	402	52%
Adjusted EBITDA	$ (65)	$ 1,013	$ (1,078)	(106)%	$ (335)	$ 2,307	$ (2,642)	(115)%

The decrease in Adjusted EBITDA for the three- and six-month periods ended June 30, 2009, compared to the corresponding three- and six-month periods ended June 30, 2008, were due primarily to lower revenues and higher operational costs incurred by Digimarc compared to the benefits received from the shared services cost allocation methodology in the predecessor financial statements.

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Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our business.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value. This statement does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS 157 is effective the first fiscal year beginning after November 15, 2007. We applied the provisions of this standard regarding the framework of measuring fair value and noted no material effect on the current financial statements.

In February 2008, the FASB issued FASB Staff Position (FSP) 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" and FSP 157-2, "Effective Date of FASB Statement No. 157". FSP 157-1 amends SFAS 157 to remove certain leasing transactions from its scope, and was effective upon initial adoption of SFAS 157. FSP 157-2 delayed the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2009. We applied the provisions of FSP 157-2 on non-financial assets and non-financial liabilities and noted no significant impact on our financial statements.

In October 2008, the FASB issued FSP 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active". FSP 157-3 clarifies the application of SFAS 157 in a market that is not active, and addresses application issues such as the use of internal assumptions when relevant observable data does not exist, the use of observable market information when the market is not active, and the use of market quotes when assessing the relevance of observable and unobservable data. FSP 157-3 is effective for all periods presented in accordance with SFAS 157. The adoption of FSP 157-3 did not have a significant impact on our financial statements or the fair values of our financial assets and liabilities.

In April 2009, the FASB issued FSP 157-4: "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly". FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157 when the volume and level of activity for the asset or liability have significantly decreased and identifying circumstances that indicate a transaction is not orderly. The adoption of FSP 157-4 did not have a significant impact on our financial statements or the fair values of our assets or liabilities.

In April 2009, the FASB issued FSP No. 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments". FSP 115-2 amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. However, it does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The adoption of FSP 115-2 did not have a significant impact on our financial statements or the fair values of our assets or liabilities.

In April 2009, the FASB issued FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments". FSP 107-1 expands the fair value disclosures required for all financial instruments within the scope of SFAS No. 107, "Disclosures about Fair Value of Financial

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Instruments," to interim periods for publicly traded entities. The adoption of FSP 107-1 did not have a significant impact on our financial statement disclosures.

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*. SFAS 165 establishes general standards of accounting for and disclosure of events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 sets forth the period after the balance sheet date during which we should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which we should recognize events or transactions occurring after the balance sheet date in our financial statements and the disclosures that we should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for interim and annual fiscal periods ending after June 15, 2009. The adoption of SFAS 165 did not have a significant impact on our financial statement disclosures. In preparing our financial statements, we evaluated subsequent events through July 31, 2009, which is the date our quarterly report was filed with the Securities and Exchange Commission.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R),* is a revision to FASB Interpretation ("FIN") No. 46 (Revised December 2003) ("FIN 46(R)), *Consolidation of Variable Interest Entities*, which changes how a reporting entity determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance. SFAS 167 is effective the first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. We do not expect the adoption of this pronouncement will have a material impact on our financial statements.

In June 2009, the FASB issued SFAS No. 168, The "*FASB Accounting Standards Codification* "*and the Hierarchy of Generally Accepted Accounting Principles.* SFAS 168 establishes the *FASB Accounting Standards Codification* (Codification) to become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. SFAS 168 and the Codification are effective for financial statements issued for interim and annual periods ending after September 15, 2009. We do not expect the adoption of this pronouncement will have a material impact on our financial statements.

Safe Harbor Statement under the Private Securities Litigation Reform Act of 1995

This Quarterly Report on Form 10-Q includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. Words such as "may," "plan," "should," "could," "expect," "anticipate," "intend," "believe," "project," "forecast," "estimate," "continue," variations of such terms or similar expressions are intended to identify such forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements, or other statements made by us, are made based on our expectations and beliefs concerning future events impacting us, and are subject to uncertainties and factors (including those specified below), which are difficult to predict and, in many instances, are beyond our control. As a result, our actual results could differ materially from those expressed in or implied by any such forward-looking statements, and investors are cautioned not to place undue reliance on such statements. Forward-looking statements include but are not limited to statements relating to:

- concentration of revenues with few customers comprising a large majority of the revenues;
- trends and expectations in revenue growth;

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- our future level of investment in our business and the joint ventures in which we have invested, including investment in development of products and technology, acquisition of new customers and development of new market opportunities;
- our ability to improve margins;
- anticipated expenses, costs, margins and investment activities in the foreseeable future;
- anticipated revenue to be generated from current contracts and as a result of new programs;
- our profitability in future periods;
- business opportunities that could require that we seek additional financing;
- the size and growth of our markets;
- the existence of international growth opportunities and our future investment in such opportunities;
- the source of our future revenue;
- our expected short-term and long-term liquidity positions;
- our ability to fund our working capital needs through cash flow from operations;
- our use of cash in upcoming quarters;
- capital market conditions, including the recent economic crisis, interest rate volatility and other limitations on the availability of capital, which could have an impact on our cost of capital and our ability to access the capital markets;
- anticipated levels of backlog and bid activity in future periods;
- anticipated transitional services expenses to be reimbursed to us by Old Digimarc;
- protection of our intellectual property portfolio; and
- other risks detailed in our filings with the Securities and Exchange Commission, including the risk factors set forth in "Item 1A. Risk Factors."

We believe that the factors described in "Item 1A. Risk Factors," among others, could affect our future performance and the liquidity and value of our securities and cause our actual results to differ materially from those expressed or implied by forward-looking statements made by us or on our behalf. Investors should understand that it is not possible to predict or identify all risk factors and that there may be other factors that may cause our actual results to differ materially from the forward-looking statements. All forward-looking statements made by us or by persons acting on our behalf apply only as of the date of this Quarterly Report. We do not undertake any obligation to publicly update or revise any forward-looking statements to reflect future events, information or circumstances that arise after the date of the filing of this Quarterly on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The market risk disclosures as set forth in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2008 have not changed materially.

Item 4T. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures, as of the end of the period covered by this Form 10-Q, were effective in ensuring that information required to be disclosed by us in reports

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that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Controls

There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934) that occurred during the quarter ended June 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION.

Item 1. Legal Proceedings.

From time to time in our normal course of business we are a party to various legal claims, actions and complaints. Currently, we do not have any pending litigation that we consider material.

Item 1A. Risk Factors

The following risks relate principally to our business and our status as a publicly-traded company. The risks and uncertainties described below are those risks of which we are aware, 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 could be materially adversely affected. In that case, the trading price of our common stock could decline. Our business, financial condition, results of operations and cash flows may be affected by a number of factors, including the factors set forth below.

(1) We have limited operating history as a separate public company and our historical financial information prior to the spin-off is not necessarily representative of the results we would have achieved as a separate publicly-traded company, and may not be a reliable indicator of our future results.

The predecessor financial statements have been "carved out" from Old Digimarc's consolidated financial statements and reflect assumptions and allocations made by Old Digimarc. The predecessor financial statements do not fully represent what the predecessor's financial position, results of operations and cash flow would have been had it operated as a stand-alone public company for the periods presented, or those that we expect to achieve in the future because, among other reasons, prior to the spin-off, the digital watermarking business was operated by Old Digimarc as part of a larger corporate organization. Significant changes may occur in our cost structure, tax structure, management, financing and business operations as a result of our operating as a public company separate from Old Digimarc. These changes may result in increased costs associated with reduced economies of scale, marketing expenses, the incurrence of debt and interest expense, stand-alone costs for services formerly provided by Old Digimarc, the need for additional personnel to perform services formerly provided by Old Digimarc, and the legal, accounting, compliance and other costs associated with being a public company with equity securities listed on a national exchange. As a result, the historical information included in this Quarterly Report on Form 10-Q is not necessarily indicative of what our future financial position, results of operations and cash flow will be. For more information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q.

(2) We have a history of losses, and although we achieved profitability in 2008, we may not sustain profitability, particularly if we were to lose large contracts.

Old Digimarc's Digital Watermarking Business had incurred significant net losses from inception. Old Digimarc's accumulated deficit was $100 million as of December 31, 2007. For the combined periods January 1, 2008 through August 1, 2008 and August 2, 2008 through December 31, 2008 we generated net income of $1,491; however, we generated a net loss for the six-month period ended June 30, 2009. Achieving profitability in the future will depend upon a variety of factors, including our ability to maintain and obtain more significant partnerships like those with the Central Banks and Nielsen, growth in revenues of our licensees, and 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 have a negative effect on our revenues, margins and profitability.

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(3) The current capital and credit market conditions may adversely affect our access to capital, cost of capital and business operations.

Recently, the general economic and capital market conditions in the U.S. and other parts of the world have deteriorated significantly and have adversely affected access to capital and increased the cost of capital. If these conditions continue or become worse, our future cost of debt and equity capital and our access to capital markets could be adversely affected. Any inability to obtain adequate financing from debt or equity capital sources could force us to self-fund strategic initiatives or even forgo some opportunities, potentially harming our business operations and results.

In addition, our ability to find investments that are both safe and liquid and that provide a reasonable return may be impaired. This could result in lower interest income, longer investment tenures or higher other-than-temporary impairments.

(4) The current economic downturn may impair the financial soundness of our licensees and customers, which could adversely affect our business operations.

As a result of the current economic downturn and macro-economic challenges currently affecting the economy of the U.S. and other parts of the world, our customers and licensees may be negatively affected in ways that reduce our revenues and margins, quality of receivables, and cash flow.

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

Historically, we have derived a significant portion of our revenues from a limited number of customers. Two customers, the Bank for International Settlements, acting on behalf of the Central Banks, and Nielsen, represented approximately 85 and 82% for the three- and six-month period ended June 30, 2009, respectively, and 77% of our revenue for the twelve-month period ended December 31, 2008. Most of our revenues come from long-term contracts generally having terms of three to five years, with some licenses for the life of the associated patents, which could be up to 20 years. Some contracts we enter into contain termination for convenience provisions. If we were to lose such a contract for any reason, 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 revenues for the foreseeable future. The loss of, or decline in, orders or backlog from one or more major customers could reduce our revenues and have a material adverse effect on our financial results.

(6) The joint ventures agreements we entered into with Nielsen may not produce marketable products that will provide a return on investment on the initial cash contributions.

We entered into two joint venture agreements with Nielsen to deliver products and services to enhance television viewing, facilitate mobile commerce, and create valuable other new opportunities for television networks and consumer brands to more deeply engage with audiences. These products and services are new and untested, and they may not have a ready market. We are nonetheless committed to provide financial support to both joint ventures through October 2011.

We cannot predict how the market will react to our product offerings or any potential revenue that may or may not be realized. Our initial investment in these two joint ventures may result in neither product offerings nor a return on investment.

(7) Our joint venture transactions with Nielsen may not realize all of their intended benefits.

In connection with TVaura LLC and TVaura Mobile LLC, our joint ventures with Nielsen, we may experience:

- difficulties in integrating our corporate culture and business objectives with that of Nielsen into the joint ventures;

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- diversion of our management's time and attention from other business objectives;
- higher than anticipated costs of integration, development and operations at the joint ventures;
- difficulties in hiring or retaining key employees who are necessary to manage the joint ventures; or
- difficulties in coordinating with an entity remote to our Beaverton, Oregon operations.

Moreover, since Nielsen has significant oversight and voting rights with respect to major business decisions of TVaura LLC and TVaura Mobile LLC, we do not have complete control over the joint ventures' operations, including business decisions that may affect each joint venture's profitability or success in meeting its objectives. For any of these reasons, or as a result of other factors, we may not realize the anticipated benefits of the joint ventures, and our participation in the joint ventures could adversely affect the results of our other business efforts.

(8) Disagreements between Nielsen and us regarding the strategy and priorities of the joint ventures or shortage of additional funding for the joint ventures may impede the development of the joint venture products, which could negatively affect the value of our investment in TVaura LLC and TVaura Mobile LLC.

TVaura LLC is a jointly owned company that we established with Nielsen to focus on the discovery, development and commercialization of copyright filtering solutions, royalty/audit for online video and audio rights organizations, guilds or other organizations involved in reconciliation of royalties, residuals and other payments, and other related products. TVaura Mobile LLC is a jointly owned company that we established with Nielsen to focus on the discovery, development and commercialization of certain enhanced television offerings, and other related products.

As part of these joint ventures, we licensed to each of TVaura LLC and TVaura Mobile LLC all of our patents and technology not already subject to exclusive license grants to other licensees. Each of TVaura LLC and TVaura Mobile LLC is operated as an independent company and governed by a members' committee. We and Nielsen can elect an equal number of representatives to serve on each members' committee. The joint venture plan to develop the contemplated products pursuant to an operating plan that is approved by the members' committee. Any disagreements between Nielsen and us regarding a development decision or any other decision submitted to either joint venture's members' committee may cause significant delays in the development and commercialization of the joint ventures' products and technology and could negatively affect the value of our investment in the joint ventures.

In addition, neither we nor Nielsen have any obligation to fund the joint ventures beyond the initial cash contributions provided in the joint venture agreements. If the joint ventures are unable to generate cash sufficient to develop and commercialize their products, and if additional funding is unavailable from us, Nielsen or third parties, we may not recognize the intended benefits of the joint ventures.

(9) A significant portion of our revenue is subject to commercial contracts and development of new markets that may involve unpredictable delays and other unexpected changes, which might limit our actual revenue in any given quarter or year.

We derive substantial portions of our revenue from commercial 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.

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(10) The market for our products is highly competitive and alternative technology or larger companies may undermine, limit or eliminate the market for our products' technologies, 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 technology. Because the market solutions based on our technologies are still in an early stage of development, we also may face competition from unexpected sources.

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

- Encryption securing data during distribution using a secret code so it cannot be accessed except by authorized users;

- Containers inserting a media object in an encrypted wrapper, which prevents the media object from being duplicated, used for content distribution and transaction management;

- DataGlyphs® a slightly visible modification of the characteristics of an image or document that is machine-readable;

- Scrambled Indicia® an optical refraction-based data-hiding technique that is inserted into an image and can be read with a lens;

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

- 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 for Images;

- 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;

- Smart cards badges and cards including a semiconductor memory and/or processor, used for authentication and related purposes; 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 environment in which we operate, product generation, development and marketing processes relating to technology are uncertain and complex, requiring accurate prediction of demand as well as successful management of various development risks inherent in technology development. In light of these dependencies, it is possible that failure to successfully accommodate future changes in technologies related to our technology could have a long-term 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 these 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 greater technical, financial, marketing, and political resources than we do. These resources could enable these companies to initiate severe price cuts or take other measures in an effort to gain market share or otherwise impede our progress. 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.

(11) 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 these 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. 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 unique and not generally known. 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 clauses generally. If these clauses were not fully enforced, our employees could be able to 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.

(12) If leading companies in our industry 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, particularly in the media and entertainment sectors.

Many of our business endeavors, such as our licensing of intellectual property in support of audio and video copy-control applications, 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 digital watermarking, particularly in the media and entertainment market. In addition, potential customers in the media and entertainment industry 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.

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(13) 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 watermarking technology could be adversely affected.

(14) 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 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.

(15) Our future growth will depend to some extent on our successful implementation of our technology in solutions provided by third parties, including partners and suppliers.

Our business and strategy rely substantially on deployment of our technology by 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. If third parties who include our technology 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 would be adversely affected and, consequently, our ability to increase revenues would be adversely affected and we may suffer other

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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 providers.

(16) Our growth of IP licensing revenues depends on successful implementation of solutions by our licensees and third parties and successful development of new markets for our technology.

Our IP licensing business and strategy rely, in part, on successful deployment of our technology by our licensees and other third-party software developers and original equipment manufacturers. For example, our technology is being deployed as part of Digital Cinema systems to theatres around the world by companies that integrate technologies and subsystems. If third parties who license our intellectual property for their products cease to do so, or we fail to obtain other partners who will incorporate, embed, integrate or bundle our technology and intellectual property, or these partners are unsuccessful in their efforts, our ability to increase licensing revenues would be adversely affected. In addition, if our technology does not perform according to market expectations, our future sales would suffer as customers seek other providers.

(17) 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. International sales and services are subject to a number of risks that can adversely affect our sales of products and services to customers outside of the U.S., including the following:

- 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.;
- difficulty in managing foreign operations; 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 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 to recover our potential losses.

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(18) 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 and milestones;
- customer acceptance and testing requirements; and
- other performance requirements.

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 programs, concerns regarding program performance and other contractual disputes. If we fail to meet contractual milestones or other 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.

(19) 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.

(20) 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.

(21) 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;

- the intense competition and rapid technological change in our industry 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 in order for our products and services to be sustainable and competitive and in order 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 revenues 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 stage 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. Additionally, 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.

(22) We may not be able to protect adequately our intellectual property, and we may be subject to infringement claims and other litigation, which could adversely affect our business.

Our success depends in part on licensing our proprietary technology. To protect our intellectual property portfolio, we rely on a combination of patent, copyright, trademark and trade secret rights, confidentiality procedures and licensing arrangements. Unlicensed copying and use of our intellectual property or infringement of our intellectual property rights may result in the loss of revenue to us. Although we devote significant resources to developing and protecting our technologies, and periodically evaluate potential competitors of our technologies for infringement of our intellectual property rights, these infringements may nonetheless go undetected or may arise in the future.

We face risks associated with our patent position, including the potential need from time to time to engage in significant legal proceedings to enforce our patents, the possibility that the validity or enforceability of our patents may be challenged, and the possibility that third parties will be able to compete against us without infringing our patents. Budgetary concerns may cause us not to file or continue litigation against known infringers of our patent rights, or may cause us not to file for, or pursue, patent protection for all of our inventive technology in jurisdictions where they may have value. Some governmental entities that might infringe our intellectual property rights may enjoy sovereign immunity from such claims. Failure to reliably enforce our patent rights against infringers may make licensing more difficult. If we fail to protect our intellectual property rights and proprietary technology adequately, if there are changes in applicable laws that are adverse to our interests, or if we become involved in litigation relating to our intellectual property rights and proprietary technology or relating to the intellectual property rights of others, our business could be seriously harmed because the value ascribed to our intellectual property could diminish and result in a lower stock price, or we may incur significant costs in bringing legal proceedings against third parties who are infringing our patents.

Effective protection of intellectual property rights may be unavailable or limited. Patent protection throughout the world is generally established on a country-by-country basis. We have applied for patent protection in the U.S. and in various other countries. We do not assure you, however, that pending patents will be issued or that issued patents will be valid or enforceable. Failure to obtain these patents or failure to enforce those patents that are obtained may result in a loss of revenue to us. 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.

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. Although we rely on some of these technologies for our products or for our licenses to third parties, to date, the licensed patents have not been material to our operations.

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, divert management resources and result in the invalidation of our intellectual property rights. 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 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 allegedly infringed upon. Similarly, as we seek to broaden the number of companies licensed under our patent portfolio, some may seek contractual assurances that we will pursue by litigation if necessary their competitors who use our patented technology but are not licensed to do so. Compliance with any such contract provisions may require that we pursue litigation where our costs exceed our likely recovery.

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,

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solutions or information. The steps that we have taken to prevent misappropriation of our solutions, technology or other proprietary information may not prevent their misappropriation.

(23) Our internal controls and procedures may not succeed in achieving their stated goals under all potential future conditions, regardless of how remote.

We have deployed significant resources to design, implement, and maintain effective internal controls and procedures, including disclosure controls and procedures. Although our internal controls and procedures are designed to provide reasonable assurance of achieving their objectives, the design of any system of controls is based in part upon various assumptions about the likelihood of future events, and our system may not succeed in achieving its stated goals under all potential future conditions, regardless of how remote. Any failure to maintain adequate controls or to adequately implement required new or improved controls could harm our operating results or cause us to fail to meet our reporting obligations in a timely and accurate manner.

(24) 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 or sustain existing revenue.

Some of our business involves embedding digital watermarks in traditional and digital media, including identification documents, secure documents, audio, video and imagery, and licensing our intellectual property. Our revenue stream is based primarily on a combination of development, consulting, subscription and license fees from copyright protection and counterfeit deterrence applications. We have not fully developed revenue models for some of our future digital watermarking 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 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.

(25) While we currently have no material claims, litigation or regulatory actions filed or pending by or against us, future claims, litigation or enforcement actions could arise, and any obligation to pay a judgment or damages could materially harm our business or financial condition.

From time to time, Old Digimarc had been engaged in litigation and incurred significant costs relating to these matters. The inherent uncertainties of litigation, and the ultimate cost and outcome of litigation cannot be predicted. We carry director and officer liability insurance and other insurance policies that provide protection against various liabilities relating to claims against us and our executive officers and directors up to prescribed policy limits. If these policies do not adequately cover expenses and liabilities relating to future lawsuits, our financial condition could be materially harmed. In addition, if this insurance coverage becomes unavailable to us or premiums increase significantly in the future, we could be exposed to potentially self-funding certain future liabilities ordinarily mitigated by director and officer liability insurance. Increased insurance risk could also make it more difficult for us to retain and attract officers and directors.

(26) 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;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- 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;
- future issuances of our common stock or the perception that future sales could occur;
- company repurchases of our common stock; and
- volatility in the equity securities market.

(27) We have the ability to issue additional equity securities, which would lead to dilution of our issued and outstanding common stock.

The issuance of additional equity securities or securities convertible into equity securities would result in dilution of our existing stockholders' equity interests. We are authorized to issue, without stockholder approval, up to 2,500,000 shares of preferred stock, par value $0.001 per share, in one or more series, which may give other stockholders dividend, conversion, voting, and liquidation rights, among other rights, which may be superior to the rights of holders of our common stock. In addition, we are authorized to issue up to 50,000,000 shares of common stock, par value $0.001 per share. We are authorized to issue, without stockholder approval except as required by law or Nasdaq regulations, securities convertible into either common stock or preferred stock.

Following the spin-off, we issued to our executive officers an aggregate of 10,000 shares of Series A Redeemable Nonvoting Preferred stock. In the event of our liquidation, dissolution or other winding up, before any payment or distribution is made to the holders of common stock, holders of the Series A Redeemable Nonvoting Preferred stock will be entitled to receive a value of $5.00 per share of Series A Redeemable Nonvoting Preferred stock held by the stockholder. The Series A Redeemable Nonvoting Preferred has no voting rights, and may be redeemed by us at any time on or after June 18, 2013.

(28) Our corporate governance documents as well as Delaware law may delay or prevent an acquisition of us that stockholders may consider favorable, which could decrease the value of your shares.

Our certificate of incorporation and bylaws and Delaware 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 stockholders to amend our organizational documents and limitations on actions by our stockholders by written consent. In addition, our board of directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Delaware law also imposes some restrictions on mergers and other business combinations between any holder of 15% or more of our outstanding common stock and us. Although we believe these provisions protect our stockholders from coercive or otherwise unfair takeover tactics and thereby provide for an opportunity to receive a higher bid by

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requiring potential acquirers to negotiate with our board of directors, these provisions apply even if the offer may be considered beneficial by some stockholders.

Item 4. Submission of Matters to a Vote of Security Holders.

We held our annual meeting of stockholders on May 1, 2009. Three proposals were voted on by our stockholders.

Proposal 1: Election of Directors

Bruce Davis, William J. Miller, James T. Richardson, Peter W. Smith and Bernard Whitney were elected as directors for a term of one year. The voting for each director was as follows:

	For	Withheld
Bruce Davis.	6,059,367	741,465
William J. Miller	6,060,298	740,534
James T. Richardson	6,060,298	740,534
Peter W. Smith	6,060,575	740,257
Bernard Whitney	6,052,360	748,472

Proposal 2: Approval and Adoption of the Digimarc Corporation 2008 Incentive Plan

The Digimarc Corporation 2008 incentive plan was approved and adopted with 2,492,719 votes in favor, 102,794 votes against and 2,223 abstentions.

Proposal 3: Ratification of the Appointment of Grant Thornton LLP as the Company's Independent Certified Public Accountants

Grant Thornton was ratified as our independent certified public accountants for the fiscal year ending December 31, 2009 with 6,727,316 votes in favor, 64,069 votes against and 9,447 abstentions.

Item 6. Exhibits.

In reviewing the agreements included as exhibits to this Quarterly Report on Form 10-Q, please remember they are included to provide you with information regarding their terms and are not intended to provide any other factual or disclosure information about Digimarc or the other parties to the agreements. The agreements may contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other party or parties to the applicable agreement and:

- should not in all instances be treated as categorical statements of fact, but rather as a means of allocating the risk to one of the parties if those statements prove to be inaccurate;
- may have been qualified by disclosures that were made to the other party or parties in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;
- may apply standards of materiality in a manner that is different from what may be viewed as material to you or other investors; and
- were made only as of the date of the applicable agreement or other date or dates that may be specified in the agreement and are subject to more recent developments.

Accordingly, there representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time. Additional information about Digimarc may be found elsewhere in this Quarterly Report on Form 10-Q, Digimarc's Annual Report on

Form 10-K for the

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year ended December 31, 2008 and in Digimarc's other public filings, which are available without charge through the SEC's website at *http://www.sec.gov*.

Exhibit Number	**Exhibit Description**
10.1*	Patent License Agreement, dated as of June 11, 2009 between Digimarc Corporation and The Nielsen Company (US), LLC
10.2*	Limited Liability Company I Agreement, dated June 11, 2009 between Digimarc Corporation and The Nielsen Company (US), LLC
10.3*	Limited Liability Company II Agreement, dated June 11, 2009 between Digimarc Corporation and The Nielsen Company (US), LLC
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer
32.2	Section 1350 Certification of Chief Financial Officer

* Confidential treatment has been requested for certain portions omitted from this exhibit pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, as amended. Confidential portions of this exhibit have been separately filed with the Securities and Exchange Commission.

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SIGNATURES

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

Date: July 31, 2009

DIGIMARC CORPORATION

By: /s/ MICHAEL MCCONNELL

Michael McConnell
Chief Financial Officer and Treasurer
(Duly Authorized Officer
and Principal Financial Officer)