

CLEARONE COMMUNICATIONS INC
Form 10-K
September 10, 2008

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

FORM 10-K

(Mark One)

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

For the fiscal year ended June 30, 2008

OR

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

For the transition period from _____ to _____

Commission file number 000-17219

CLEARONE COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Utah 87-0398877
(State or (I.R.S.
other Employer
jurisdiction of Identification
incorporation No.)
or
organization)

5225 Wiley Post Way, Suite 500
Salt Lake City, Utah 84116
(Address of principal executive offices, including zip code)

(801) 975-7200
(Registrant's telephone number, including area code)

Securities registered under Section 12(b) of the Act: Title of each class	Name of each exchange on which registered
---	--

Edgar Filing: CLEARONE COMMUNICATIONS INC - Form 10-K

Common Stock, \$0.001 par value The NASDAQ Capital Market

Securities registered under Section 12(g) of the Act: None

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

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

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

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

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

Larger Accelerated Filer Accelerated Filer

Non-Accelerated Filer Smaller Reporting Company

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. The aggregate market value of the shares of voting common stock held by non-affiliates was approximately \$48,415,000 at December 31, 2007, based on the \$5.42 closing price for the Company's common stock on the NASDAQ Capital Market on such date. For purposes of this computation, all officers, directors, and 10% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed to be an admission that such officers, directors, or 10% beneficial owners are, in fact, affiliates of the registrant.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. The number of shares of ClearOne common stock outstanding as of September 9, 2008 was 10,230,968.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the Annual Meeting of Shareholders to be held November 14, 2008 are incorporated by reference into Part III of this report.

INDEX

	PAGE
SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS	1
PART I.	
<u>ITEM 1.</u> BUSINESS	1
<u>ITEM 1A.</u> RISK FACTORS	12
<u>ITEM 1B.</u> UNRESOLVED STAFF COMMENTS	17
<u>ITEM 2.</u> PROPERTIES	18
<u>ITEM 3.</u> LEGAL PROCEEDINGS	18
<u>ITEM 4.</u> SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	20
PART II.	
<u>ITEM 5.</u> MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES	21
<u>ITEM 6.</u> SELECTED FINANCIAL DATA	23
<u>ITEM 7.</u> MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	26
<u>ITEM 7A.</u> QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	36
<u>ITEM 8.</u> FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA	36
<u>ITEM 9.</u> CHANGE IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	36
<u>ITEM 9A.</u> CONTROLS AND PROCEDURES	37
<u>ITEM 9B.</u> OTHER INFORMATION	37
PART III.	
<u>ITEM 10.</u> DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT	38
<u>ITEM 11.</u> EXECUTIVE COMPENSATION	38
<u>ITEM 12.</u> SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	38
<u>ITEM 13.</u> CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS	38
<u>ITEM 14.</u> PRINCIPAL ACCOUNTANT FEES AND SERVICES	38
PART IV.	
<u>ITEM 15.</u> EXHIBITS AND FINANCIAL STATEMENT SCHEDULES	39
<u>SIGNATURES</u>	41

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements reflect our views with respect to future events based upon information available to us at this time. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from these statements. Forward-looking statements are typically identified by the use of the words “believe,” “may,” “could,” “will,” “should,” “expect,” “anticipate,” “estimate,” “project,” “propose,” “plan,” “intend,” and similar expressions. Examples of forward-looking statements are statements that describe the proposed development, manufacturing, and sale of our products; statements that describe our results of operations, pricing trends, the markets for our products, our anticipated capital expenditures, our cost reduction and operational restructuring initiatives, and regulatory developments; statements with regard to the nature and extent of competition we may face in the future; statements with respect to the sources of and need for future financing; and statements with respect to future strategic plans, goals, and objectives. Forward-looking statements are contained in this report under “Description of Business” included in Item 1 of Part I, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Qualitative and Quantitative Disclosures About Market Risk” included in Items 7 and 7A of Part II of this Annual Report on Form 10-K. The forward-looking statements are based on present circumstances and on our predictions respecting events that have not occurred, that may not occur, or that may occur with different consequences and timing than those now assumed or anticipated. Actual events or results may differ materially from those discussed in the forward-looking statements as a result of various factors, including the risk factors discussed in this report under the caption “Item 1A: Risk Factors.” These cautionary statements are intended to be applicable to all related forward-looking statements wherever they appear in this report. The cautionary statements contained or referred to in this report should also be considered in connection with any subsequent written or oral forward-looking statements that may be issued by us or persons acting on our behalf. Any forward-looking statements are made only as of the date of this report and ClearOne assumes no obligation to update forward-looking statements to reflect subsequent events or circumstances.

PART I

References in this Annual Report on Form 10-K to “ClearOne,” “we,” “us,” “CLRO” or “the Company” refer to ClearOne Communications, Inc., a Utah corporation, and, unless the context otherwise requires or is otherwise expressly stated, its subsidiaries.

ITEM 1. BUSINESS

Overview

We are an audio conferencing products company. We develop, manufacture, market, and service a comprehensive line of high-quality audio conferencing products, which range from personal conferencing products to tabletop conferencing phones to professionally installed audio systems. We also manufacture and sell conferencing furniture. We have a strong history of product innovation and plan to continue to apply our expertise in audio engineering to develop and introduce innovative new products and enhance our existing products. We believe the performance and reliability of our high-quality audio products create a natural communications environment, which saves organizations of all sizes time and money by enabling more effective and efficient communication.

Our products are used by organizations of all sizes to accomplish effective group communication. Our end-users range from some of the world’s largest and most prestigious companies and institutions to small and medium-sized businesses, educational institutions, and government organizations as well as individual consumers. We sell our products to these end-users primarily through a network of independent distributors who in turn sell our products to dealers, systems integrators, and value-added resellers. The Company also sells products on a limited basis directly to

dealers, systems integrators, value-added resellers, and end-users.

ClearOne was formed as a Utah corporation in 1983 organized under the laws of the State of Utah. Our website address is www.clearone.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to such reports are available, free of charge, on our website as soon as reasonably practicable after we file electronically such material with, or furnish it to, the Securities and Exchange Commission.

For a discussion of certain risks applicable to our business, results of operations, financial position, and liquidity see the risk factors described in “Items 1A, Risk Factors” below.

Business Strategy

ClearOne currently participates in the following audio conferencing markets:

Market	Typical Number of Participants
· Professional Conferencing:	20-200
· Premium Conferencing	8-30
· Tabletop Conferencing	1-30
· Personal Conferencing	1-15

Our goal is to maintain our market leadership in the professional or installed segment of the audio conferencing systems market, continue building on our leadership in premium conferencing, the conferencing category we created, further penetrating the tabletop conferencing space and continue evaluating the best method for marketing and gaining traction in the personal conferencing market. We will continue to improve our existing high-quality products and develop additional new products as we build on what we believe to be the most advanced, highest-quality and most complete audio conferencing product line on the market. The principal components of our strategy to achieve this goal are set forth below.

Provide a superior conferencing experience

We have been developing audio technologies since 1981 and believe we have established a reputation for providing some of the highest quality group audio conferencing solutions in the industry. Our proprietary audio signal processing technologies, including Distributed Echo Cancellation®, have been the core of our professional conferencing products and are the foundation for our new product development in other conferencing categories. We plan to build upon our reputation of being a market leader and continue to provide the highest quality products and technologies to the customers and markets we serve.

Offer greater value to our customers

To provide our customers with audio conferencing products that offer high value, we are focused on listening to our customers and delivering products to meet their needs. By offering high quality products that are designed to solve conferencing ease-of-use issues and are easy to install, configure, and maintain, we believe we can provide greater value to our customers and enhance business communications and decision making.

Leverage and extend ClearOne technology leadership and innovation

We have sharpened our focus on developing cutting edge audio conferencing products and are committed to incorporating the latest technologies into our new and existing product lines. Key to this effort is adopting emerging technologies such as Voice over Internet Protocol (or VoIP), high definition audio, wireless connectivity, the convergence of voice and data networks, exploring new application models for our premium and personal audio conferencing technologies, and developing products based on internationally accepted standards and protocols.

Expand and strengthen sales channels

We continue to expand and strengthen domestic and international sales channels through the addition of key distributors and dealers that expand beyond our traditional audio-video channels that carry our professional conferencing line. We continue to direct significant sales efforts toward channel partners who are focused on the tabletop conferencing space. We also continue to strengthen our presence within the telephony reseller channel, which is best suited to sell our RAV premium conferencing systems, MAX tabletop conference phones, and CHAT personal conferencing products.

Broaden our product offerings

We believe that we offer the industry's most complete audio conferencing product line, including the following:

- Professionally installed audio conferencing systems that are used in executive boardrooms, courtrooms, hospitals, and auditoriums that integrate with all leading video and telepresence systems
 - Premium conferencing systems that integrate with video and web conferencing systems
 - Tabletop conferencing phones used in conference rooms and offices
- Personal conferencing devices that enable hands-free audio communications in new ways that have never before been possible.

We plan to continue to broaden and expand our product offerings to meet the evolving needs of our customers, address changes in the markets we currently serve, and effectively target new markets for our products.

Develop strategic partnerships

To stay on the leading edge of product and market developments, we plan to continue to identify partners with expertise in areas strategic to our growth objectives. We will work to develop partnerships with leaders in markets complimentary to conferencing who can benefit from our audio products and technologies and through whom we can access new market growth opportunities.

Strengthen existing customer relationships through dedicated support

We have developed outstanding technical and sales support teams that are dedicated to providing customers with the best available service and support. We believe our technical support is recognized as among the best in the industry and we will continue to invest in the necessary resources to ensure that our customers have access to the information and support they need to be successful in using our products. We also dedicate significant resources to providing product training to our channel partners worldwide.

Markets and Products

Our business is primarily focused on audio conferencing. We also previously operated in the conferencing services segment until July 1, 2004 (fiscal 2005), when we sold our conferencing services business to Clarinet, Inc., an affiliate of American Teleconferencing Services, Ltd. doing business as Premiere Conferencing and in the business services segment until March 4, 2005 (fiscal 2005), when we sold the remaining operations in that area to 6351352 Canada Inc., a Canada corporation.

Products Overview

The performance and reliability of our high-quality audio conferencing products enable effective and efficient communication between geographically separated businesses, employees, and customers. We offer a full range of audio conferencing products, from high-end, professionally installed audio conferencing systems used in executive boardrooms, courtrooms, hospitals, classrooms, and auditoriums, to premium conferencing systems that interface with video and web conferencing systems, to tabletop conference phones used in conference rooms and offices, and to personal conferencing devices that can be used with laptops and other portable devices. For each of the last three fiscal years, our professionally installed audio conferencing and tabletop conference phones have each contributed in excess of 15 percent of our consolidated revenue. Our audio conferencing products feature our proprietary Distributed Echo Cancellation® and noise cancellation technologies to enhance communication during a conference call by eliminating echo and background noise. Most of our products also feature proprietary audio processing technologies such as

adaptive modeling and first-microphone priority, which combine to deliver clear, crisp, full-duplex audio. This enables natural communication between distant conferencing participants similar to that of being in the same room.

We believe the principal drivers of demand for audio conferencing products are the following:

- Increasing availability of easy-to-use audio conferencing equipment
- Improving voice quality of audio conferencing systems compared to telephone handset speakerphones
- Trending expansion of global, regional, and local corporate enterprises

Other factors that we expect to have a significant impact on the demand for audio conferencing systems include:

- Availability of a wider range of affordable audio conferencing products for small businesses and home offices
 - Growth of distance learning and corporate training programs
 - Trend toward deploying greater numbers of teleworkers
- Decreases in the amount of travel within most enterprises for routine meetings
- Transition to the Internet Protocol, or IP, network from the traditional public switched telephone network, or PSTN and the deployment of VoIP applications

We expect these growth factors to be offset by direct competition from high-end telephone handset speakerphones, new and existing competitors in the audio conferencing space, the technological volatility of IP-based products, and continued pressures on enterprises to reduce spending.

Professional Audio Conferencing Products

We have been developing high-end, professionally installed audio conferencing products since 1991 and believe we have established strong brand recognition for these products worldwide. Our professional audio conferencing products include the Converge™ Pro, Converge Amplifiers, XAP® and Converge 560/590 product lines. The Converge SR 1212 product features similar technologies and is used for sound reinforcement applications.

The recently launched Converge Pro is expected to eventually replace the popular XAP® series of audio conferencing systems. The Converge Pro series delivers a significant feature set and performance improvements including unprecedented proprietary acoustical echo cancellation, noise cancellation, full duplex performance, enhanced management capabilities, and simplified configuration utilities. The Converge SR 1212 is a digital matrix mixer that provides advanced audio processing, microphone mixing, and routing for local sound reinforcement.

The Converge Pro, XAP and SR 1212 products are comprehensive audio processing systems designed to excel in the most demanding acoustical environments and routing configurations. These products are also used for integrating high-quality audio with video and web conferencing systems.

Our customers asked for a professional audio solution that was less expensive and would fit the budgetary requirements for a mid-range conference room. The Converge 560 and Converge 590 professional conferencing systems fill this need. These products are positioned between our Professional and Premium conferencing product lines both in terms of functionality and price, and are an excellent fit for rooms requiring customized microphone and speaker configurations (up to nine microphones can be connected) along with connectivity to video and web conferencing systems. The Converge products also offer speech lift to amplify a presenter's voice in the local room.

In June 2008, we introduced the Converge Amplifiers. There are two models of the Converge Amplifiers, the PA2250 and the PA4160. The PA 2250 is a two-channel amplifier that provides 250 watts per channel while the PA 4160 is a four-channel amplifier, providing 160 watts per channel. The PA 2250 and PA 4160, with their ample power and exceptional audio performance, satisfy the demand for high definition, multi-channel audio for conferencing, rich media presentations, and sound reinforcement applications.

ClearOne also offers a Tabletop Controller for the Converge Pro and XAP platforms. This affordable solution gives users the ability to easily start and navigate an audio conference without the need for touch panel control systems, which can be expensive, complex, or intimidating to users. The dial pad on the device resembles a telephone keypad for instant familiarity and users can dial a conference call as easily as dialing a telephone, with little or no training required. The Tabletop Controller can cost thousands less than touch-screen panel control systems and its simplified setup for the user-definable keys can save customers programming time and expense as well. Along with its sleek, functional design, this latest offering from ClearOne delivers what we believe to be the most cost-effective, attractive and easy-to-use control solution for Converge Pro and XAP systems on the market.

In March 2007, Frost and Sullivan, an analyst group that focuses on the conferencing industry, awarded ClearOne their 2007 Product Line Strategy Award. This award is presented each year to a company that has demonstrated the most insight into customer needs and product demands within their industry, and has optimized its product line by leveraging products with the various price, performance, and feature points required by the market. Frost & Sullivan noted that ClearOne is now firmly focused on developing and marketing a broad and comprehensive portfolio of best-in-class audio conferencing products, from professional audio systems, through to tabletop products and VoIP personal conferencing PC peripherals. They also lauded ClearOne's strategy in expanding its portfolio, leveraging its technology leadership in the professional audio space with its market-leading XAP, Converge 560/590, and Converge Pro product lines.

Premium Conferencing Systems

Since 2004, we have provided our RAV audio conferencing system which is a complete, out-of-the-box system that includes an audio mixer, Bose® loudspeakers, microphones, and a control device that can be either wired or wireless. The RAV product uniquely combines the sound quality of a professionally installed audio system with the simplicity of a conference phone and can be easily connected to rich-media devices, such as video or web conferencing systems, to deliver enhanced audio performance. RAV is strategically positioned between our professional and tabletop conferencing systems in price and functionality, and fills an important audio conferencing application need for rooms requiring integration of high-end audio quality with web or video conferencing.

RAV offers many powerful audio processing technologies from our professional audio conferencing products without the need for professional installation and programming. It features Distributed Echo Cancellation, noise cancellation, microphone gating, and a drag-and-drop graphical user interface for easy system setup, control, and management.

Tabletop Conferencing Phones

Since 2003 we have provided our MAX line of tabletop conferencing phones. These phones encapsulate the high-end echo cancellation, noise cancellation, and audio processing technologies found in our professional audio conferencing products.

The MAX product line is comprised of four product families: the MAX® EX, MAXAttach™; MAX Wireless, MAXAttach Wireless; and MAX IP™, MAXAttach IP™ tabletop conferencing phones. MAX Wireless was the industry's first wireless conferencing phone. Designed for use in executive offices or small conference rooms with multiple participants, MAX Wireless can be moved from room to room within 150 feet of its base station. MAXAttach Wireless began shipping in May 2005 and was the industry's first and only dual-phone, completely wireless solution. This system gives customers tremendous flexibility in covering larger conference room areas.

The MAX EX and MAXAttach wired phones feature a unique capability – instead of just adding extension microphones for use in larger rooms, the conference phones can be daisy chained together, up to a total of four phones. This provides even distribution of microphones, loudspeakers, and controls for better sound quality and improved user access in medium to large conference rooms. In addition, all MAXAttach wired versions can be separated and used as single phones in smaller conference rooms.

Our latest additions to the MAX family are the MAX IP and MAXAttach IP, ClearOne's first VoIP tabletop conference phones, which are based on the industry-standard SIP signaling protocol. These phones feature the same ability to daisy-chain up to four phones together, providing outstanding room coverage that other VoIP conference phones on the market cannot match.

Personal Conferencing Products

In April 2006, we began shipping the CHAT™ 50 personal speaker phone. This revolutionary crossover technology delivers ClearOne's trademark crystal-clear full-duplex audio performance, and can be used in a variety of applications with a wide number of devices including the following:

5

PCs & Macs	VoIP telephony applications such as Skype & Vonage; enterprise softphones; audio for web-based videoconferencing applications; gaming; audio playback
Cell phones	Connects to the 2.5mm headset jack of many cell phones for hands-free, full-duplex audio conferencing
Telephones	Connects to the headset jack (certain phone models) for hands-free, full-duplex audio conferencing
iPods & MP3 players	For full-bandwidth audio playback
Desktop video conferencing systems	For hands-free, full-duplex audio conferencing

Through public relations efforts by ClearOne, the CHAT 50 has garnered significant media coverage and won PC Magazine's Editors' Choice Award.

The CHAT 150 began shipping in January 2007 and is the latest product to join ClearOne's personal conferencing category. It offers many of the same connectivity options as the CHAT 50, but comes in a larger form factor and features three microphones compared to the single microphone on the CHAT 50 for use by a larger number of participants. The CHAT 150 connects to enterprise telephone handsets, PCs, and video conferencing systems. ClearOne believes the primary opportunity for the CHAT 150 is in connecting to the enterprise handset. Customers will now have the ability to add a high-quality, full-duplex speaker phone to their handsets, and still retain the full functionality that comes with today's handsets, including access to company directory, voicemail access, audio bridge functions, and other features.

The CHAT 50 and CHAT 150 have also become popular with large enterprises and other software and hardware vendors due to their audio quality and flexibility. Several large enterprise customers bundle the CHAT products with a video conferencing system that they provide to their remote employees. We also have OEM agreements with several manufacturers who have chosen the CHAT products as the preferred audio endpoint to their video conferencing equipment or web collaboration software.

Other Products

We complement our audio conferencing products with microphones, conferencing-specific furniture, and until August 2006, document and education cameras. Our wide selection of wood, metal, and laminate conferencing furniture features audiovisual carts; plasma screen carts and pedestals; and video conferencing carts, tables, cabinets, and podiums.

Marketing and Sales

We use a two-tier channel distribution model, in which we primarily sell our products directly to a worldwide network of independent audiovisual, information technology, and telecommunications distributors, who then sell our products to independent systems integrators, dealers, and value-added resellers, who in turn work directly with the end-users of our products on product fulfillment and installation. We also sell our products on a limited basis directly to certain dealers, systems integrators, value-added resellers, and end-users.

In fiscal 2008, approximately \$27.8 million, or 70 percent, of our total product sales were generated in the United States and product sales of approximately \$11.9 million, or 30 percent, were generated outside the United States. Revenue from product customers outside of the United States accounted for approximately 29 percent of our total product sales from continuing operations for fiscal 2007 and 28 percent for fiscal 2006. We sell our products in more than 70 countries worldwide. We anticipate that the portion of our total product revenue from international sales will continue to increase as we further enhance our focus on developing new products, establishing new channel partners, strengthening our presence in key growth areas, complying with regional environmental regulatory standards, and improving product localization with country-specific product documentation and marketing materials.

Distributors

We sell our products directly to approximately 70 distributors throughout the world. Distributors purchase our products at a discount from list price and resell them on a non-exclusive basis to independent systems integrators, dealers, and value-added resellers. Our distributors maintain their own inventory and accounts receivable and are required to provide technical and non-technical support for our products to the next level of distribution participants. We work with our distributors to establish appropriate inventory stocking levels. We also work with our distributors to maintain relationships with our existing systems integrators, dealers, and value-added resellers.

Independent Integrators, Dealers, and Resellers

Our distributors sell our products worldwide to approximately 1,000 independent systems integrators, telephony value-added resellers, IT value-added resellers, and PC dealers on a non-exclusive basis. While dealers, resellers, and systems integrators all sell our products directly to the end-users, systems integrators typically add significant value to each sale by combining our products with products from other manufacturers as part of an integrated system solution. Dealers and value-added resellers usually buy our products from distributors and may bundle our products with products from other manufacturers for resale to the end-user. We maintain close working ties in the field with our reseller partners and offer them education and training on all of our products.

Marketing

Much of our marketing effort is done in conjunction with our channel partners, who provide leverage for ClearOne in reaching customers and prospective customers worldwide. We also regularly attend industry forums and exhibit our products at trade shows, including the following:

- InfoComm – the AV industry’s largest trade show. In June 2008 we had a strong presence at InfoComm, where we highlighted a significant number of new products.
- National Systems Contractors Association – this show focuses on the sound reinforcement industry, and we highlight our professional audio conferencing products.
- A/V Integrator trade shows – we regularly invest and participate in trade shows hosted by our partners, namely system integrators.

In addition, there are multiple regional and international shows that we attend along with our channel partners. These shows provide exposure for ClearOne’s brand and products to the wide audience of show attendees.

We also have a highly-focused public relations effort to get editorial coverage on ClearOne’s products in industry and non-industry publications alike.

Customers

We do not believe that any end-user accounted for more than 10 percent of our total revenue during fiscal 2008, 2007, or 2006. In fiscal 2008, revenues included sales to three distributors that represented approximately 60 percent of total revenue. Each of these three distributors, NewComm Distributing, Starin Marketing and VSO Marketing, accounted for more than 10 percent of consolidated revenue. As discussed above, these distributors facilitate product sales to a large number of resellers, and subsequently to their end-users. Nevertheless, the loss of one or more distributors could reduce revenue and have a material adverse effect on our business and results of operations. As of June 30, 2008, our shipped orders on which we had not recognized revenue were \$4.6 million and our backlog of unshipped orders was

\$1.1 million.

Competition

The conferencing products market is characterized by intense competition and rapidly evolving technology. We compete with businesses having substantially greater financial, research and product development, manufacturing, marketing, and other resources. If we are not able to continually design, manufacture, and successfully market new or enhanced products or services that are comparable or superior to those provided by our competitors and at comparable or better prices, we could experience pricing pressures and reduced sales, gross profit margins, profits, and market share, each of which could have a materially adverse effect on our business.

Our competitors vary within each product category. We believe we are able to differentiate ourselves and therefore successfully compete as a result of the high audio quality of our products resulting from our proprietary audio signal processing technologies and technical support services as well as the strength of our brand, particularly in the professional conferencing space.

We believe the principal factors driving sales are the following:

- channel partnerships;
- our ability to effectively communicate the differentiated value-added features of our products through sales and marketing efforts;
 - product design, quality, and functionality of products;
 - establishment of brand name recognition;
 - pricing;
 - access to and penetration of distribution channels;
 - quality of customer support; and
 - a significant customer base.

In the professional audio conferencing systems and sound reinforcement markets, our main competitors include Polycom, Biamp Systems, Lectrosonics, Peavey, Shure, and WideBand Solutions, with several other companies potentially poised to enter the market. According to industry sources, we have held the largest share of the installed segment of the conferencing systems market for many years, which we target with our professional audio conferencing products. ClearOne uniquely contributed to the professional conferencing space with the introduction of the Audio Perfect (“AP”) product line a number of years ago, followed by the XAP and continue the tradition of offering state of the art, differentiated professional product with the introduction of Converge Pro. We believe we continue to enjoy a strong reputation with the AV integrators and AV consultants for our product features, audio quality, and technical support.

We believe we created a new audio conferencing category with the introduction of the RAV platform, which we call premium conferencing. RAV is a unique product with capabilities we do not believe can be found on any other competing system.

In the tabletop conferencing space, our primary competitors are Polycom, Aethra, Konftel, LifeSize, Panasonic, and a number of other smaller manufacturers. Despite having been in this space for a relatively short time, we quickly grew and continue to enjoy the number two position worldwide, second to the incumbent, Polycom. We believe we have obtained the number two position as a result of differentiating our MAX products on a number of fronts; they are more competitively priced than Polycom’s comparable products; MAX encapsulates our proprietary digital signal processing technologies which we believe are the most advanced in the industry; and our unique ability to attach or daisy chain multiple phones together for increased coverage has given us opportunities to solve customer problems that our competition cannot currently solve.

The new personal conferencing space has seen a number of new entries. Our primary competitors in the personal conferencing space are Polycom, Actiontec, Iogear, mVox, Phoenix, and USRobotics. We believe that our CHAT 50

and CHAT 150 offer unique and distinct advantages in their superior audio performance and their abilities to connect to multiple devices and to be used in multiple scenarios. Our microphones compete with the products of Audio Technica, Global Media, Harmon Music, Shure, and others. Our conferencing furniture products compete primarily with the products of Accuwood, Comlink, and Video Furniture International.

In each of the markets in which we compete, many of our competitors may have access to greater financial, technical, manufacturing, and marketing resources, and as a result they may respond more quickly or effectively to new technologies and changes in customer preferences. We cannot provide assurance that we will continue to compete effectively in the markets we serve.

Regulatory Environment

Regulations regarding the materials used in manufacturing, the process of disposing of electronic equipment and the efficient use of energy require additional time to obtain regulatory approvals of new products in international markets. Such regulations may impact our ability to expand our sales in a timely and cost-effective manner and as a result our business could be harmed.

Sources and Availability of Raw Materials

Most of the components that we purchase from various vendors are readily available from a number of sources. Alternative sourcing of various components is continually underway. Vendors are qualified by Corporate Quality Assurance. We have a vendor quality monitoring program that includes routinely checking incoming material for conformance to specifications, as required per written procedures.

Seasonality

Our audio conferencing products revenue has historically been strongest during the second and fourth quarters. There can be no assurance that any historic sales patterns will continue and, as a result, sales for any prior quarter are not necessarily indicative of the sales to be expected in any future quarter.

Product Development

We are committed to research and product development and view our continued investment in research and product development as a key ingredient to our long-term business success. Our research and product development expenditures were approximately \$7.1 million in fiscal 2008, \$7.5 million in fiscal 2007, and \$8.3 million in fiscal 2006.

Our core competencies in research and product development include many audio technologies, including telephone echo cancellation, acoustic echo cancellation, and noise cancellation. Our ability to use digital signal processing technology to perform audio processing operations is also a core competency. We also have in-house expertise in wireless technologies, VoIP, and software and network application development. We believe that ongoing development of our core technological competencies is vital to maintaining and increasing future sales of our products and to enhancing new and existing products.

Manufacturing

Currently, all of our products are manufactured by third-party manufacturers.

We believe the long-term benefits from our manufacturing outsourcing strategy include the following:

- Avoidance of a significant investment in upgrading our manufacturing infrastructure;
 - RoHS-compliant manufacturing facilities;
- Scalability in our manufacturing process without major investment or major restructuring costs;
- Achievement of future cost reductions on manufacturing costs and inventory costs based upon increased economies of scale in material and labor; and
- Manufacturing world class quality products by partnering with outsource manufacturers certified with International Organization of Standardization (ISO) processes.

Intellectual Property and Other Proprietary Rights

We believe that our success depends in part on our ability to protect our proprietary rights. We rely on a combination of patent, copyright, trademark, and trade secret laws and confidentiality agreements and processes to protect our proprietary rights. The laws of foreign countries may not protect our intellectual property to the same degree as the laws of the United States.

We generally require our employees, customers, and potential distribution participants to enter into confidentiality and non-disclosure agreements before we disclose any confidential aspect of our technology, services, or business. In addition, our employees are required to assign to us any proprietary information, inventions, or other technology created during the term of their employment with us. However, these precautions may not be sufficient to protect us from misappropriation or infringement of our intellectual property.

We currently have about 30 patents that are issued, pending, or applied for that cover our conferencing products and technologies. The expiration dates of issued patents range from 2018 to 2025. We hold or have filed for over 70 trademarks. Registered trademarks include ClearOne, XAP, MAX, AccuMic, Audio Perfect, Distributed Echo Cancellation, Gentner, and others. We have also filed for trademarks for RAV, Converge, Chat, and others. We have received or filed for registered copyrights of certain of our source code for acoustic echo cancellation and other related audio signal processing algorithms.

Employees

As of June 30, 2008, we had 103 employees, 100 of whom were employed on a full-time basis, with 36 in sales, marketing, and customer support; 37 in product development; 16 in operations support; and 14 in administration, including finance. Of these employees, 86 were located in our Salt Lake City office, 12 in other U.S. locations, two in the United Kingdom and three in Asia. None of our employees are subject to a collective bargaining agreement and we believe our relationship with our employees is good. We occasionally hire contractors with specific technology skill sets to meet project timelines.

Dispositions

During the fiscal year ended June 30, 2001, we completed the sale of the assets of the remote control portion of our RFM/Broadcast division to Burk Technology, Inc.. During fiscal 2005, we sold our conferencing services segment to Premiere and we sold our Canadian audiovisual integration services business to 6351352 Canada Inc. During fiscal 2006, we sold our document and educational camera product line to Ken-A-Vision Manufacturing Co. Inc. Each disposition is summarized below and is discussed in detail in the footnotes to the June 30, 2008 consolidated financial statements included in this report.

Sale of Assets to Burk Technology. On April 12, 2001, we sold the assets of the remote control portion of our RFM/Broadcast division to Burk, a privately held developer and manufacturer of broadcast facility control systems products, for \$750,000 in cash at closing, \$1.8 million in the form of a seven-year promissory note, with interest at the rate of 9.0 percent per year, and up to \$700,000 as a commission over a period of up to seven years. We realized a pre-tax gain on the sale of \$1.3 million for fiscal 2006, \$187,000 for fiscal 2005, and \$93,000 for fiscal 2004. On August 22, 2005, we entered into a Mutual Release and Waiver Agreement with Burk pursuant to which Burk paid us \$1.3 million in full satisfaction of the promissory note, which included a discount of \$119,000. As part of the Mutual Release and Waiver Agreement, we waived any right to future commission payments from Burk and we granted mutual releases to one another with respect to claims and liabilities. Accordingly, the total pre-tax gain on the sale was approximately \$2.4 million.

Sale of our Conferencing Services. During July 2004, we sold our conferencing services business segment to Premiere. Consideration for the sale consisted of \$21.3 million in cash. Of the purchase price, \$300,000 was placed into a working capital escrow account and an addition \$1.0 million was placed into an 18 month indemnity escrow account. We received the \$300,000 working capital escrow funds approximately 90 days after the execution date of the agreement. We received the \$1.0 million in the indemnity escrow account together with the \$30,000 in related interest income in January 2006. Additionally, \$1.4 million of the proceeds was utilized to pay off equipment leases pertaining to assets being conveyed to Premiere. We realized a pre-tax gain on the sale of \$1.0 million in fiscal 2006

and \$17.4 million in fiscal 2005.

Sale of OM Video – Canadian Audiovisual Integration Services. During March 2005, we sold all of the issued and outstanding stock of our Canadian subsidiary, ClearOne Communications of Canada, Inc. (“ClearOne Canada”) to 6351352 Canada Inc., a Canada corporation. ClearOne Canada owned all the issued and outstanding stock of Stechyson Electronics, Ltd., which conducts business under the name OM Video. We agreed to sell the stock of ClearOne Canada for \$200,000 in cash; a \$1.3 million note receivable over a 15-month period, with interest accruing on the unpaid balance at the rate of 5.3 percent per year; and contingent consideration ranging from 3.0 percent to 4.0 percent of related gross revenues over a five-year period. In June 2005, we were advised that the OM Purchaser had settled an action brought by the former employer of certain of OM Purchaser’s owners and employees alleging violation of non-competition agreements. The settlement reportedly involved a cash payment and an agreement not to sell certain products for a period of one year. Based on an analysis of the facts and circumstances that existed at the end of fiscal 2005, and considering the guidance from Topic 5U of the SEC Rules and Regulations, “Gain Recognition on the Sale of a Business or Operating Assets to a Highly Leveraged Entity,” the gain is being recognized as cash is collected (as collection was not reasonably assured). Through December 31, 2005, all required payments had been made however, 6351352 Canada Inc. failed to make any subsequent, required payments under the note receivable until June 30, 2006, when we received a payment of \$50,000. During fiscal 2007, we reevaluated our options and concluded that its best course of action was to enforce our security and appoint a receiver over the assets of OM Video.

Sale of our Document and Educational Camera Product Line. In August 2006, we sold our document and educational camera product line to Ken-A-Vision Manufacturing Co. Inc., a privately held manufacturer of camera solutions for education, audio visual, research, and manufacturing applications. Under the terms of the transaction, Ken-A-Vision received the intellectual property rights to ClearOne's camera technologies, as well as ownership of current inventory. The sale price was \$635,000 payable in cash and a \$318,000 note receivable payable over 24 months.

ITEM 1A. RISK FACTORS

Investors should carefully consider the risks described below. The risks described below are not the only ones we face and there are risks that we are not presently aware of or that we currently believe are immaterial that may also impair our business operations. Any of these risks could harm our business. The trading price of our common stock could decline significantly due to any of these risks, and investors may lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Annual Report on Form 10-K, including our June 30, 2008 consolidated financial statements and related notes.

Risks Relating to Our Business

We face intense competition in all markets for our products and services; our operating results will be adversely affected if we cannot compete effectively against other companies.

The markets for our products and services are characterized by intense competition and pricing pressures and rapid technological change. We compete with businesses having substantially greater financial, research and product development, manufacturing, marketing, and other resources. If we are not able to continually design, manufacture, and successfully introduce new or enhanced products or services that are comparable or superior to those provided by our competitors and at comparable or better prices, we could experience pricing pressures and reduced sales, gross profit margins, profits, and market share, each of which could have a materially adverse effect on our business.

Difficulties in estimating customer demand in our products segment could harm our profit margins.

Orders from our distributors and other distribution participants are based on demand from end-users. Prospective end-user demand is difficult to measure. This means that our revenue during any fiscal quarter could be adversely impacted by low end-user demand, which could in turn negatively affect orders we receive from distributors and dealers. Our expectations for both short- and long-term future net revenues are based on our own estimates of future demand.

Revenue for any particular time period are difficult to predict with any degree of certainty. We usually ship products within a short time after we receive an order; so consequently, unshipped backlog has not been a good indicator of future revenue. We believe that the current level of backlog will fluctuate dependent in part on our ability to forecast revenue mix and plan our manufacturing accordingly. A significant portion of our customers' orders are received during the last month of the quarter. We budget the amount of our expenses based on our revenue estimates. If our estimates of sales are not accurate and we experience unforeseen variability in our revenue and operating results, we may be unable to adjust our expense levels accordingly and our gross profit and results of operations will be adversely affected. Higher inventory levels or stock shortages may also result from difficulties in estimating customer demand.

Our sales depend to a certain extent on government funding and regulation.

In the audio conferencing products market, the revenue generated from sales of our audio conferencing products for distance learning and courtroom facilities depend on government funding. In the event government funding for such initiatives was reduced or became unavailable, our sales could be negatively impacted. Additionally, many of our products are subject to governmental regulations. New regulations could significantly impact sales in an adverse manner.

Environmental laws and regulations subject us to a number of risks and could result in significant costs and impact on revenue

Regulations regarding the materials used in manufacturing, the process of disposing of electronic equipment and the efficient use of energy require additional time to obtain regulatory approvals of new products in international markets. Such regulations may impact our ability to expand our sales in a timely and cost-effective manner and as a result our business could be harmed.

Product development delays or defects could harm our competitive position and reduce our revenue.

We have, in the past, and may again experience, technical difficulties and delays with the development and introduction of new products. Many of the products we develop contain sophisticated and complicated circuitry, software and components, and utilize manufacturing techniques involving new technologies. Potential difficulties in the development process that could be experienced by us include difficulty in the following:

- meeting required specifications and regulatory standards;
 - meeting market expectations for performance;
- hiring and keeping a sufficient number of skilled developers;
 - obtaining prototype products at anticipated cost levels;
- having the ability to identify problems or product defects in the development cycle; and
 - achieving necessary manufacturing efficiencies.

Once new products reach the market, they may have defects, or may be met by unanticipated new competitive products, which could adversely affect market acceptance of these products and our reputation. If we are not able to manage and minimize such potential difficulties, our business and results of operations could be negatively affected.

Our profitability may be adversely affected by our continuing dependence on our distribution channels.

We market our products primarily through a network of distributors who in turn sell our products to systems integrators, dealers, and value-added resellers. All of our agreements with such distributors and other distribution participants are non-exclusive, terminable at will by either party, and generally short-term. No assurances can be given that any or all such distributors or other distribution participants will continue their relationship with us. Distributors and to a lesser extent systems integrators, dealers, and value-added resellers cannot easily be replaced and the loss of revenues and our inability to reduce expenses to compensate for the loss of revenue could adversely affect our net revenue and profit margins.

Although we rely on our distribution channels to sell our products, our distributors and other distribution participants are not obligated to devote any specified amount of time, resources, or efforts to the marketing of our products or to sell a specified number of our products. There are no prohibitions on distributors or other resellers offering products that are competitive with our products and some do offer competitive products. The support of our products by distributors and other distribution participants may depend on the competitive strength of our products and the price incentives we offer for their support. If our distributors and other distribution participants are not committed to our products, our revenue and profit margins may be adversely affected.

Additionally, we offer our distributors price protection on their inventory of our products. If we reduce the list price of our products, we will compensate our distributors for the respective products that remain in their inventory on the date the price adjustment becomes effective provided that they have taken delivery of the product(s) within the last 35 days. Our net revenue and profit margins could adversely be affected if we reduce product price(s) significantly and/or distributors happen to have significant inventory on-hand of the affected product at the time of a price reduction. Further, if we do not have sufficient cash resources to compensate distributors on terms satisfactory to them or us, our price protection obligations may prevent us from reacting quickly to competitive market conditions.

Reporting of channel inventory by certain distributors.

We defer recognition of revenue from product sales to distributors until the return privilege has expired, which approximates when product is sold-through to customers of our distributors. We evaluate, at each quarter-end, the inventory in the channel through information provided by certain of our distributors. We use this information along

with our judgment and estimates to determine the amount of inventory in the entire channel, for all customers and for all inventory items, and the appropriate revenue and cost of goods sold associated with those channel products. We cannot guarantee that the third party data, as reported, or that our assumptions and judgments regarding total channel inventory revenue and cost of goods sold will be accurate. We periodically audit a limited number of distributors.

We depend on an outsourced manufacturing strategy.

We outsource the manufacture of all of our products to third-party manufacturers located in both the U.S. and Asia. If any of these manufacturers experience difficulties in obtaining sufficient supplies of components, component prices significantly exceed anticipated costs, an interruption in their operations, or otherwise suffer capacity constraints, we would experience a delay in shipping these products which would have a negative impact on our revenue. Should there be any disruption in services due to natural disaster, economic or political difficulties, quarantines, transportation restrictions, acts of terror, or other restrictions associated with infectious diseases, or other similar events, or any other reason, such disruption would have a material adverse effect on our business. Operating in the international environment exposes us to certain inherent risks, including unexpected changes in regulatory requirements and tariffs, and potentially adverse tax consequences, which could materially affect our results of operations. Currently, we have no second source of manufacturing for a portion of our products.

The cost of delivered product from our contract manufacturers is a direct function of their ability to buy components at a competitive price and to realize efficiencies and economies of scale within their overall business structure. If they are unsuccessful in driving efficient cost models, our delivered costs could rise, affecting our profitability and ability to compete. In addition, if the contract manufacturers are unable to achieve greater operational efficiencies, delivery schedules for new product development and current product delivery could be negatively impacted.

We depend on an outsourced fulfillment strategy.

During January 2008, we commenced the use of a third party supply chain management firm who manages the receiving, storing, picking, packing, shipping and inventory management of the majority of our products. If this firm experiences difficulties or interruptions in its operations preventing it from adequately fulfilling our products, we would experience a delay in shipping product to our customers which would negatively impact our revenues. Should there be any disruption in the third party's services as a result of natural disaster, economic or political difficulties, quarantines, labor disputes, transportation restrictions, acts of terror or other similar events, such disruption would have a material adverse effect on our business. Currently, we do not have a second source for fulfillment of the majority of our products.

Product obsolescence could harm demand for our products and could adversely affect our revenue and our results of operations.

Our industry is subject to rapid and frequent technological innovations that could render existing technologies in our products obsolete and thereby decrease market demand for such products. If any of our products become slow-moving or obsolete and the recorded value of our inventory is greater than its market value, we will be required to write down the value of our inventory to its fair market value, which would adversely affect our results of operations. In limited circumstances, we are required to purchase components that our outsourced manufacturers use to produce and assemble our products. Should technological innovations render these components obsolete, we will be required to write down the value of this inventory, which could adversely affect our results of operations.

If we are unable to protect our intellectual property rights or have insufficient proprietary rights, our business would be materially impaired.

We currently rely primarily on a combination of trade secrets, copyrights, trademarks, patents, patents pending, and nondisclosure agreements to establish and protect our proprietary rights in our products. No assurances can be given that others will not independently develop similar technologies, or duplicate or design around aspects of our technology. In addition, we cannot assure that any patent or registered trademark owned by us will not be invalidated, circumvented or challenged, or that the rights granted hereunder will provide competitive advantages to us. Litigation

may be necessary to enforce our intellectual property rights. We believe our products and other proprietary rights do not infringe upon any proprietary rights of third parties; however, we cannot assure that third parties will not assert infringement claims in the future. Our industry is characterized by vigorous protection of intellectual property rights. Such claims and the resulting litigation are expensive and could divert management's attention, regardless of the merit of such claims. In the event of a claim, we might be required to license third-party technology or redesign our products, which may not be possible or economically feasible.

We currently hold only a limited number of patents. To the extent that we have patentable technology for which we have not filed patent applications, others may be able to use such technology or even gain priority over us by patenting such technology themselves.

International sales account for a significant portion of our net revenue and risks inherent in international sales could harm our business.

International sales represent a significant portion of our total product revenue. We anticipate that the portion of our total product revenue from international sales will continue to increase as we further enhance our focus on developing new products for new markets, establishing new distribution partners, strengthening our presence in emerging economies, and improving product localization with country-specific product documentation and marketing materials. Our international business is subject to the financial and operating risks of conducting business internationally, including the following:

- unexpected changes in, or the imposition of, additional legislative or regulatory requirements;
 - unique environmental regulations;
 - fluctuating exchange rates;
 - tariffs and other barriers;
 - difficulties in staffing and managing foreign sales operations;
 - import and export restrictions;
- greater difficulties in accounts receivable collection and longer payment cycles;
 - potentially adverse tax consequences;
- potential hostilities and changes in diplomatic and trade relationships; and
- disruption in services due to natural disaster, economic or political difficulties, quarantines, transportation, or other restrictions associated with infectious diseases.

We may not be able to hire and retain qualified key and highly-skilled technical employees, which could affect our ability to compete effectively and may cause our revenue and profitability to decline.

We depend on our ability to hire and retain qualified key and highly skilled employees to manage, research and develop, market, and service new and existing products. Competition for such key and highly-skilled employees is intense, and we may not be successful in attracting or retaining such personnel. To succeed, we must hire and retain employees who are highly skilled in the rapidly changing communications and Internet technologies. Individuals who have the skills and can perform the services we need to provide our products and services are in great demand. Because the competition for qualified employees in our industry is intense, hiring and retaining employees with the skills we need is both time-consuming and expensive. We might not be able to hire enough skilled employees or retain the employees we do hire. In addition, provisions of the Sarbanes-Oxley Act of 2002 and related rules of the SEC impose heightened personal liability on some of our key employees. The threat of such liability could make it more difficult to identify, hire and retain qualified key and highly-skilled employees. We have relied on our ability to grant stock options as a means of recruiting and retaining key employees. Recent accounting regulations requiring the expensing of stock options will impair our future ability to provide these incentives without incurring associated compensation costs. Our inability to hire and retain employees with the skills we seek could hinder our ability to sell our existing products, systems, or services or to develop new products, systems, or services with a consequent adverse effect on our business, results of operations, financial position, or liquidity.

We rely on third-party technology and license agreements.

We have licensing agreements with various suppliers for software and hardware incorporated into our products. These third-party licenses may not continue to be available to us on commercially reasonable terms, if at all. The termination or impairment of these licenses could result in delays of current product shipments or delays or reductions in new product introductions until equivalent designs could be developed, licensed, and integrated, if at all possible, which would have a material adverse effect on our business.

We may have difficulty in collecting outstanding receivables.

We grant credit to substantially all of our customers without requiring collateral. In times of economic uncertainty, the risks relating to the granting of such credit would typically increase. Although we monitor and mitigate the risks associated with our credit policies, we cannot ensure that such mitigation will be effective. We have experienced losses due to customers failing to meet their obligations. Future losses could be significant and, if incurred, could harm our business and have a material adverse effect on our operating results and financial position.

Interruptions to our business could adversely affect our operations.

As with any company, our operations are at risk of being interrupted by earthquake, fire, flood, and other natural and human-caused disasters, including disease and terrorist attacks. Our operations are also at risk of power loss, telecommunications failure, and other infrastructure and technology based problems. To help guard against such risks, we carry business interruption loss insurance to help compensate us for losses that may occur.

Risks Relating to Share Ownership

Our stock price fluctuates as a result of the conduct of our business and stock market fluctuations.

The market price of our common stock has experienced significant fluctuations and may continue to fluctuate significantly. The market price of our common stock may be significantly affected by a variety of factors, including the following:

- statements or changes in opinions, ratings, or earnings estimates made by brokerage firms or industry analysts relating to the market in which we do business or relating to us specifically;
 - disparity between our reported results and the projections of analysts;
- the shift in sales mix of products that we currently sell to a sales mix of lower-gross profit product offerings;
 - the level and mix of inventory levels held by our distributors;
 - the announcement of new products or product enhancements by us or our competitors;
 - technological innovations by us or our competitors;
 - success in meeting targeted availability dates for new or redesigned products;
- the ability to profitably and efficiently manage our supplies of products and key components;
 - the ability to maintain profitable relationships with our customers;
 - the ability to maintain an appropriate cost structure;
 - quarterly variations in our results of operations;
- general consumer confidence or general market conditions or market conditions specific to technology industries;
 - domestic and international economic conditions;
 - unexpected changes in regulatory requirements and tariffs;
 - our ability to report financial information in a timely manner; and
 - the markets in which our stock is traded.

Rights to acquire our common stock could result in dilution to other holders of our common stock.

As of June 30, 2008, we had outstanding options to acquire approximately 1.2 million shares of our common stock at a weighted average exercise price of \$5.85 per share. An additional 996,000 shares remain available for grant under our 2007 Plan. During the terms of these options, the holders thereof will have the opportunity to profit from an increase in the market price of the common stock. The existence of these options may adversely affect the terms on which we can obtain additional financing, and the holders of these options can be expected to exercise such options at a time when we, in all likelihood, would be able to obtain additional capital by offering shares of our common stock on terms more favorable to us than those provided by the exercise of these options.

Sales of additional shares of our common stock could have a negative effect on the market price of our common stock.

Sales of substantial amounts of our common stock in the public market could adversely affect prevailing market prices and could impair our ability to raise capital through the sale of our equity securities. Most shares of common stock currently outstanding are eligible for sale in the public market, subject in certain cases to compliance with the

requirements of Rule 144 under the securities laws. Shares issued upon the exercise of stock options granted under our stock option plan generally will be eligible for sale in the public market. We also have the authority to issue additional shares of common stock and shares of one or more series of preferred stock. The issuance of such shares could dilute the voting power of the currently outstanding shares of our common stock and could dilute earnings per share.

We have previously identified material weaknesses in our internal controls.

In our Form 10-K for the fiscal year ending June 30, 2006, we reported and identified a material weakness in our internal controls. Although we believe we have remedied this weakness through the commitment of considerable resources, we are always at risk that any future failure of our own internal controls or the internal control at any of our outsourced manufacturers or partners could result in additional reported material weaknesses. Any future failures of our internal controls could have a material impact on our market capitalization, results of operations, or financial position, or have other adverse consequences.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

We currently occupy a 36,279 square-foot facility in Salt Lake City, Utah under the terms of an operating lease expiring in December 2013 which supports our principal administrative, sales, marketing, customer support, and research and product development facility. We also occupy an approximate 6,500 square-foot facility in Salt Lake City under the terms of an operating lease expiring in December 2011 which supports our repair center. Finally, we lease an approximate 2,000 square-foot warehouse in Hong Kong under the terms of an operating lease expiring in February 2010 which supports our partners and customers located in the Asia-Pacific region.

We believe our current facilities are adequate to meet our needs for the foreseeable future and that suitable additional or alternative space will be available in the future on commercially reasonable terms as needed.

ITEM 3. LEGAL PROCEEDINGS

In addition to the legal proceedings described below, we are also involved from time to time in various claims and other legal proceedings which arise in the normal course of our business. Such matters are subject to many uncertainties and outcomes that are not predictable. However, based on the information available to us and after discussions with legal counsel, we do not believe any such other proceedings will have a material, adverse effect on our business, results of operations, financial position, or liquidity, except as described below.

Former Officer Indemnification. On July 25, 2007, the U.S. Attorney's Office for the District of Utah indicted two of our former officers, Frances Flood and Susie Strohm, for allegedly causing us to issue materially misstated financial statements for our 2001 and 2002 fiscal years. On January 31, 2008, the U.S. Attorney's Office filed a Second Superseding Indictment further alleging perjury in connection with the prior investigation by the SEC into the alleged misstatements. We are cooperating fully with the U.S. Attorney's Office in this matter and have been advised that we are neither a target nor a subject of the investigation or indictment. In December 2003, ClearOne entered into indemnification agreements with each former officer, requiring payment of all reasonable attorney's fees and costs incurred in defending against the charges in certain circumstances consistent with and subject to limitations under applicable law. To date, we have paid approximately \$1.8 million in reasonable attorney's fees and costs to defend against the charges. As of August 21, 2008, these former officers have requested advancement of an additional \$365,000 in legal fees and costs incurred as of that date, which amounts we have not paid. On August 21, 2008, Ms. Strohm and her counsel filed a lawsuit in the Third Judicial District Court in Salt Lake City, Utah seeking a declaratory judgment and injunctive relief to compel us to continue to advance Ms. Strohm's attorney's fees and costs to defend against the charges, plus interest for amounts previously requested and not paid. Also on August 21, 2008, Ms. Flood filed a lawsuit in Federal District Court for the District of Utah, seeking similar relief. A trial date has been set for October 20, 2008 although we were informed on August 29, 2008 that the attorney's representing the former officers filed a joint motion to continue the trial.

We have accrued for legal fees and costs of the probable amount the Company was able to estimate of its contingent liability under the indemnification agreements at June 30, 2008. In accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies", we have accrued a total of \$3.3 million, the balance of which was about \$1.5 million at June 30, 2008 representing the probable amount that, as of the date of the financial statements, could be reasonably estimated of our contingent liability, through trial, under the indemnification agreements if required under applicable law. The accrual is management's best estimate of our contingent liability as of the date of the issuance of its financial statements. In accordance with SFAS No. 5, we will adjust our contingent liability, as necessary, to reflect the probable amount that can be reasonably estimated. Our actual liability may be higher or lower than management's estimate upon final resolution of the matter. We will adjust our contingent liability, as needed, so that it remains an estimable and probable amount of our contingent financial liability as of the date of issuance of the applicable financial statements.

Theft of Intellectual Property and Copyright Complaints. In January 2007, we filed a lawsuit in the Third Judicial District Court, Salt Lake County, State of Utah against WideBand Solutions, Inc. and two of its principals, one former employee named Dr. Jun Yang, and one previously affiliated with an entity which sold certain assets to us (the "Intellectual Property Case"). ClearOne also brought claims against Biamp Systems Corporation, Inc. The matter was subsequently removed to federal court, the United States District Court, District of Utah, Central Division. The case is styled ClearOne Communications, Inc. v. Jun Yang, et. al. Civil No. 2:07-co-37 TC. The Complaint brings claims against different combinations of the defendants for, among other things, misappropriation of certain trade secrets, breach of contract, conversion, unjust enrichment and intentional interference with business and contractual relations, primarily in relation to certain algorithms and computer code. The relief being sought by us includes an order enjoining the defendants from further use of our trade secrets and an award consisting of, among other things, compensation and damages related to the unjust enrichment of the defendants. The court subsequently granted leave to add a third WideBand principal as a defendant to the case. In August 2007, we filed a motion for a preliminary injunction in the Intellectual Property Case, in the United States District Court, District of Utah, seeking to enjoin Wideband Solutions, Inc. from licensing certain technology we believe constitutes our intellectual property and trade secrets to Harman Music Group, Inc. On September 13, 2007, the court in the Intellectual Property Case granted ClearOne leave to add Harman and a former ClearOne employee working for Harman as defendants in that case. For procedural reasons, these claims against Harman and the Harman employee were refiled in Utah state court, the Third Judicial District Court for Salt Lake County, on September 18, 2007 (the "Harman Case"). Like the Intellectual Property Case, the Harman Case also brings claims related to the theft and misuse of ClearOne's confidential and trade secret information. On October 30, 2007, the Chief Judge of the United States District Court in the Intellectual Property Case, the Honorable Tena Campbell, issued a Memorandum Decision and Order (the "Injunction Order"). The Injunction Order "GRANTS ClearOne's motion for a Preliminary Injunction," and orders that "Dr. Yang, as well as his agents, servants, officers, employees, entities and those acting under his direction and control, are hereby enjoined from working on or delivering any computer code – either source code or object code – to Harman until the completion of the trial." In reaching its decision, the Court found that Dr. Yang was subject to a valid and enforceable Confidentiality, Non-Competition, and Invention Assignment Agreement (the "NDA"), and that ClearOne had demonstrated "a substantial likelihood that ClearOne will succeed on its claims that Dr. Yang violated the NDA" and derived the code that WideBand was attempting to license to Harman from code belonging to ClearOne. The Injunction Order is Docket Entry 572. On November 5, 2007, the Honorable Tena Campbell issued an order establishing the amount for the bond to be posted by ClearOne in conjunction with the Court's grant of ClearOne's motion for a preliminary injunction. The bond was set in the amount of \$907,909. In accordance with the order, we placed the bond with the clerk of the Court on November 6, 2007. On June 20, 2008, the Honorable Tena Campbell issued an order reducing the bond to \$210,000.

During October 2007, we filed a second action against WideBand and the same three principals named as defendants in the Intellectual Property Case, this time alleging copyright infringement, vicarious copyright infringement, and contributory copyright infringement (the "Copyright Case"). The claims in the Copyright Case arise out of a copyright issued to the Company for the same intellectual property, including the algorithms and computer code that is the subject of the claims in the Intellectual Property Case. The relief being sought by us includes an order enjoining the defendants from further use of our copyrighted material, and an award consisting of, among other things, compensation and damages related to the copyright infringement.

During June 2008, ClearOne filed a separate action in the United States District Court, District of Utah, Central Division, against WideBand Solutions, Inc., a Georgia corporation ("WideBand Georgia") and Donald Bowers, and the Complaint brings claims, among others, for declaratory judgment, fraudulent transfer under Utah Code Ann. § 25-6-1, et. seq., and misappropriation of trade secrets.

During June 2008, the United States District Court entered an order granting ClearOne's request for a temporary restraining order ("TRO") against any sale or transfer of ownership of certain assets of WideBand to WideBand

Solutions, Inc., a Georgia Corporation. The TRO provides that "ClearOne has met the elements necessary for issuance of a TRO to preserve the status quo," and imposes certain prohibitions against any sale or transfer of ownership of certain of the Defendants' assets, consisting of certain computer code and algorithms related thereto. The TRO also states that none of the Defendants' profits from the Disputed Code shall be transferred or conveyed to the Georgia entity.

Subsequently, during July 2008, ClearOne filed a motion for an additional TRO, to prevent the sale or transfer of any assets not already subject to the court's June 2008 TRO. On July 10, 2008, the court was informed that the proposed sale of certain assets and/or business interests to WideBand Georgia had been rescinded, and on July 10, 2008, the court denied ClearOne's July 2, 2008 application for a TRO as "moot." The June 26, 2008 TRO remains in effect.

The Shareholder Derivative Actions. Between March and August 2003, four shareholder derivative actions were filed in the Third Judicial District Court of Salt Lake County, State of Utah, by certain of our shareholders against various present and past officers and directors and against Ernst & Young. The complaints asserted allegations similar to those asserted in the SEC complaint that was filed on January 15, 2003 with regard to alleged improper revenue recognition practices and the shareholders' class action that was filed on June 30, 2003 and also alleged that the defendant directors and officers violated their fiduciary duties to us by causing or allowing us to recognize revenue in violation of U.S. GAAP and to issue materially misstated financial statements and that Ernst & Young breached its professional responsibilities to us and acted in violation of U.S. GAAP and generally accepted auditing standards by failing to identify or prevent the alleged revenue recognition violations and by issuing unqualified audit opinions with respect to our fiscal 2002 and 2001 financial statements. One of these actions was dismissed without prejudice during June 2003. As to the other three actions, our Board of Directors appointed a special litigation committee of independent directors to evaluate the claims. The special committee determined that the maintenance of the derivative proceedings against the individual defendants was not in our best interests. Accordingly, during December 2003, we moved to dismiss those claims. During March 2004, our motions were granted, and the derivative claims were dismissed with prejudice as to all defendants except Ernst & Young. We were substituted as the plaintiff in the action and are now pursuing in our own name the claims against Ernst & Young. The dates of the arbitration case management have been scheduled including commencement of the hearing on April 20, 2009.

The Insurance Coverage Action. On February 9, 2004, ClearOne and Edward Dallin Bagley ("Bagley"), a former director and significant shareholder of ClearOne, jointly filed an action in the United States District Court for the District of Utah, Central Division, against National Union Fire Insurance Company of Pittsburgh, Pennsylvania ("National Union") and Lumbermens Mutual Insurance Company ("Lumbermens Mutual"), the carriers of certain prior period directors and officers' liability insurance policies, to recover the costs of defending and resolving claims against certain of our present and former directors and officers in connection with the SEC complaint filed on January 15, 2003, the shareholders' class action filed on June 30, 2003, and the shareholder derivative actions described above, and seeking other damages resulting from the refusal of such carriers to timely pay the amounts owing under such liability insurance policies. This action has been consolidated into a declaratory relief action filed by one of the insurance carriers on February 6, 2004 against ClearOne and certain of its current and former directors. In this action, the insurers assert that they are entitled to rescind insurance coverage under our directors and officers' liability insurance policies, \$3.0 million of which was provided by National Union and \$2.0 million which was provided by Lumbermens Mutual, based on alleged misstatements in our insurance applications. In February 2005, we entered into a confidential settlement agreement with Lumbermens Mutual pursuant to which ClearOne and Bagley received a lump-sum cash amount and the plaintiffs agreed to dismiss their claims against Lumbermens Mutual with prejudice. The cash settlement is being held in a segregated account until the claims involving National Union have been resolved, at which time the amounts received in the action will be allocated between the Company and Bagley. The amount distributed to us and Bagley will be determined based on future negotiations between us and Bagley. We cannot currently estimate the amount of the settlement which it will ultimately receive. Upon determining the amount of the settlement which we will ultimately receive, we will record this as a contingent gain. During October 2005, the court granted summary judgment in favor of National Union on its rescission defense and accordingly entered a judgment dismissing all of the claims asserted by ClearOne and Mr. Bagley. In connection with the summary judgment, we have been ordered to pay approximately \$59,000 in costs. However, due to the Lumbermens Mutual cash proceeds discussed above and the appeal of the summary judgment ruling discussed below, this potential liability has not been recorded in the balance sheet as of June 30, 2008. On February 2, 2006, we and Mr. Bagley appealed the summary judgment ruling to the U.S. Court of Appeals for the Tenth Circuit, and on July 25, 2007, the Tenth Circuit issued its decision reversing the summary judgment as to ClearOne's claims but affirming it as to Bagley's claims. The case has been remanded back to the district court for trial on ClearOne's claims for breach of contract and for breach of the implied covenant of good faith and fair dealing and on National Union's defenses, including its rescission defense. No assurances can be given that we will prevail at trial. We and Bagley have entered into a Joint Prosecution and Defense Agreement in connection with the action under which we are obligated to pay all

litigation expenses in the case except those which are solely related to Bagley's claims. (See "Item 13. Certain Relationships and Related Transactions").

These litigations are subject to all of the risks and uncertainties of litigation and there can be no assurance as to the probable result of the litigations.

ITEM 4. SUBMISSION OF MATERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of security holders through the solicitation of proxies or otherwise during the fourth quarter of the fiscal year covered by this report.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES AND EQUITY SECURITIES

Market Information

Our common stock has been traded on the Nasdaq Capital Market under the symbol CLRO since August 14, 2007. Prior to that time, our common stock was quoted on the Over the Counter Bulletin Board. The over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down, or commission and may not necessarily represent actual transactions. The following table sets forth high and low sale prices (or high and low bid quotations) of our common stock for each fiscal quarter indicated as reported on the applicable exchange or market.

	2008		2007	
	High	Low	High	Low
First Quarter	\$ 7.25	\$ 4.40		