Zagg INC
Form 10-Q
November 09, 2010

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

FORM 10-Q

[X] Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2010, 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 No. 001-34528
ZAGG INCORPORATED
(Exact name of registrant as specified in its charter)

Nevada	20-2559624
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3855 South 500 West, Suite J
Salt Lake City, Utah 84115
(Address of principal executive offices with zip code)

(801) 263-0699
(Registrant's telephone number, including area code)

Check whether the issuer (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 [X] No[ ].

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [ ] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. [ ] Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-25 of the Exchange Act).
Yes [ ] No [X]

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 23,655,703 common shares as of November 9, 2010.

ZAGG INCORPORATED AND SUBSIDIARY
FORM 10-Q

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PART I - FINANCIAL INFORMATION

ZAGG INCORPORATED AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2010	December 31, 2009
ASSETS		
Current assets		
Cash	$5,885,935	$4,970,756
Accounts receivable, net	14,144,051	5,450,722
Inventories	10,389,926	3,695,840
Prepaid expenses and other current assets	4,053,858	1,911,335
Convertible bridge loan	1,371,000	1,151,000
Deferred income tax assets	255,653	255,653
Total current assets	36,100,423	17,435,306
Property and equipment, net	1,063,858	887,705
Deferred income tax assets	446,154	446,154
Other assets	26,336	9,688
Intangible assets, net	146,310	119,627
Total assets	$37,783,081	$18,898,480
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$8,496,250	$2,781,425
Accrued liabilities	4,521,563	1,252,461
Accrued wages and wage related expenses	264,794	164,495
Deferred revenue	312,909	262,937
Sales returns liability	1,376,281	550,201
Total current liabilities	14,971,797	5,011,519
Total liabilities	14,971,797	5,011,519
Stockholders' equity		
Common stock, $0.001 par value; 50,000,000 shares authorized; 23,135,278 and 21,690,195 shares issued and outstanding, respectively	23,135	21,712
Additional paid-in capital	11,599,758	9,239,285
Cumulative translation adjustment	(110,819)	(112,039)
Retained earnings	11,299,210	4,738,003

Total stockholders' equity	22,811,284	13,886,961
Total liabilities and stockholders' equity	$37,783,081	$18,898,480

See accompanying notes to condensed consolidated financial statements.

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ZAGG INCORPORATED AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Net sales	$23,055,763	$9,728,528	$46,882,039	$26,964,159
Cost of sales	11,475,606	4,521,555	22,839,969	11,055,903
Gross profit	11,580,157	5,206,973	24,042,070	15,908,256
Operating expenses:				
Advertising and marketing	1,480,740	1,327,126	3,558,411	4,168,854
Selling, general and administrative	3,946,121	2,408,559	9,774,293	6,801,112
Total operating expenses	5,426,861	3,735,685	13,332,704	10,969,966
Income from operations	6,153,296	1,471,288	10,709,366	4,938,290
Other (expense) income:				
Interest expense	-	(62,034)	(242,617)	(64,654)
Interest and other income	4,136	49,107	17,699	141,381
Total other (expense) income	4,136	(12,927)	(224,918)	76,727
Income before provision for income taxes	6,157,432	1,458,361	10,484,448	5,015,017
Income tax provision	(2,298,340)	(550,280)	(3,923,240)	(1,884,432)
Net income	$3,859,092	$908,081	$6,561,208	$3,130,585
Basic net income per common share	$0.17	$0.04	$0.29	$0.15
Diluted net income per common share	$0.16	$0.04	$0.28	$0.14
Weighted average number of shares outstanding - basic	22,565,300	21,540,033	22,375,468	20,630,819
Weighted average number of shares outstanding - diluted	24,029,177	24,252,718	23,707,530	22,902,264

See accompanying notes to condensed consolidated financial statements.

ZAGG INCORPORATED AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Nine Months Ended September 30, 2010	2009
Cash flows from operating activities		
Net income	$6,561,208	$3,130,585
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Non-cash expense related to stock-based compensation	676,837	498,781
Depreciation and amortization	239,127	171,973
Expense related to issuance of warrants	30,548	-
Bad debt expense	-	86,921
Foreign currency translation adjustment	1,220	(27,264)
Changes in assets and liabilities		
Accounts receivable	(8,693,329)	(2,371,446)
Inventories	(6,694,086)	(1,575,053)
Prepaid expenses and other current assets	(2,142,523)	(2,178,548)
Other assets	(16,648)	-
Accounts payable	5,714,824	847,071
Accrued liabilities	3,269,102	(76,109)
Accrued wages and wage related expenses	100,299	29,974
Deferred revenues	49,972	(96,853)
Deferred tax liabilities	-	1,322,548
Sales return liability	826,080	44,455
Net cash used in operating activities	(77,369)	(192,965)
Cash flows from investing activities		
Payments for intangible assets	(36,000)	(54,636)
Payment for convertible bridge loan	(220,000)	(1,151,000)
Purchase of property and equipment	(405,963)	(426,831)
Net cash used in investing activities	(661,963)	(1,632,467)
Cash flows from financing activities		
Payments on debt	-	(20,223)
Proceeds from exercise of warrants and options	1,654,511	-
Proceeds from issuance of common stock and warrants	-	2,882,782
Net cash provided by financing activities	1,654,511	2,862,559
Net increase in cash and cash equivalents	915,179	1,037,127
Cash and cash equivalents at beginning of the period	4,970,756	1,065,652
Cash and cash equivalents at end of the period	$5,885,935	$2,102,779

Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$242,617	$62,034
Cash paid during the period for taxes	$730,599	-

See accompanying notes to condensed consolidated financial statements.

ZAGG INCORPORATED AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
(Unaudited)

Supplemental schedule of noncash investing and financing activities

For the Nine Months Ended September 30, 2010:

Issued 100,000 warrants issued for consulting services valued at $30,548.

For the Nine Months Ended September 30, 2009:

Issued 175,000 warrants issued for commissions valued at $115,536.

See accompanying notes to condensed consolidated financial statements.

ZAGG INCORPORATED AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation – The accompanying unaudited condensed consolidated financial statements of ZAGG Incorporated (collectively, the "Company" or "ZAGG") have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the following disclosures are adequate to make the information presented not misleading. The Company suggests that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's 2009 Annual Report on Form 10-K.

These condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of management, are necessary to present fairly the financial position and results of operations of the Company for the periods presented.

Operating results for the nine months ended September 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

Nature of Operations – The Company provides innovative consumer products like films, skins, audio and power solutions that protect, personalize, and enhance the mobile experience. The Company's products are distributed worldwide under the brands invisibleSHIELD™, ZAGGskins™ , ZAGGsparq™ , ZAGGbuds™ and ZAGG LEATHERskins™ . The Company's flagship product, the patent-pending invisibleSHIELD, is the original thin film full-body protector, and is available in over 5,000 precision pre-cut designs with a lifetime replacement warranty. The Company's products are available online at ZAGG.com and in major retailers around the globe, including Best Buy, AT&T, Target, Verizon, RadioShack, Cricket, Carphone Warehouse and hundreds of other retailers.

Estimates – The discussion and analysis of the Company's financial condition and results of operations are based on the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates based on historical experience and on various other assumptions that are believed to be reasonable under 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. Significant estimates include the allowance for doubtful accounts, inventory valuation allowances, sales returns and warranty liability and the useful life of property and equipment.

Principles of Consolidation – The condensed consolidated financial statements include the accounts of ZAGG Incorporated, and its wholly owned subsidiary ZAGG Europe Ltd. All significant intercompany transactions have been eliminated in consolidation.

Revenue recognition – The Company records revenue when persuasive evidence of an arrangement exists or product delivery has occurred, the sales price to the customer is fixed or determinable, and collectability is reasonably assured. The Company's revenue is derived from sales of its products through its indirect channel including retailers and distributors and through its direct channel including ZAGG.com and its corporate owned mall kiosks, and from the fees derived from the sale of exclusive independent distributor licenses related to the kiosk program. For sales of product, the Company's standard shipping terms are FOB shipping point and the Company records revenue when the product is shipped, net of estimated returns and discounts. For some customers, the contractual shipping terms are FOB destination, for these shipments, the Company records revenue when the product is delivered, net of estimated returns and discounts. For license fees, the Company recognizes revenue on a straight-line basis over the life of the license term.

ZAGG INCORPORATED AND SUBSIDIARY
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(Unaudited)

Any incentives received from vendors are recognized as a reduction of the cost of products. Promotional products given to customers or potential customers are recognized as a cost of sales. Cash incentives provided to its customers are recognized as a reduction of the related sale price, and, therefore, are a reduction in sales.

Reserve for Sales Returns and Warranty Liability – The Company's return policy generally allows its end users and retailers to return purchased products for refund or in exchange for new products within 45 days of end user purchase. The Company estimates a reserve for sales returns and records that reserve amount as a reduction of sales and as a sales return reserve liability. The sales return liability was $1,376,281 at September 30, 2010 and $550,201 at December 31, 2009.

The Company generally provides the ultimate consumer a warranty with each product and accrues warranty expense at the time of the sale based on the Company's prior claims history. Actual warranty costs incurred are charged against the accrual when paid. During the nine months ended September 30, 2010 and 2009, warranty expense and the reserve for warranty liability, respectively, was not material.

Shipping and Handling Costs – Amounts invoiced to customers for shipping and handling are included in sales and were $1,363,608 and $1,135,934 for the nine months ended September 30, 2010 and 2009, respectively. Actual shipping and handling costs to ship products to customers are included in cost of sales and were $5,689,232 and $3,519,721 for the nine months ended September 30, 2010 and 2009, respectively.

Stock-based compensation – As required by generally accepted accounting principles, the Company recognizes the cost resulting from all stock-based payment transactions including shares issued under its stock option plans in the financial statements based upon the fair value of such equity instruments granted. For the nine months ended September 30, 2010, the Company recognized stock-based compensation expense of $676,837, related to the issuance of common stock and options issued under its stock incentive plan.

Advertising – Advertising is expensed as incurred. Advertising expenses were $3,558,411 and $4,168,854 for the nine months ended September 30, 2010 and 2009, respectively.

Foreign Currency Transactions – The condensed consolidated financial statements are presented in U.S. Dollars ("USD"). The Company's primary operations are at the parent level, which uses the USD as its functional currency.

Reclassifications – Certain amounts in the financial statements of the prior periods have been reclassified to conform to the current period presentation for comparative purposes.

Basic and Fully Diluted Net Income Per Common Share – Basic net income per share is computed by dividing net income by weighted average number of shares of common stock outstanding during each period. Diluted net income per share is computed by dividing net income by the weighted average number of shares of common stock, common stock equivalents and potentially dilutive securities outstanding during each period.

The following is a reconciliation of the numerator and denominator used to calculate Basic and Diluted EPS:

	Net Income	Weighted Average	Per Share Amount

		Shares	
Three months ended September 30, 2010:			
Basic EPS	$3,859,092	22,565,300	$0.17
Effect of common stock equivalents	—	1,463,877	
Diluted EPS	$3,859,092	24,029,177	$0.16
Three months ended September 30, 2009:			
Basic EPS	$908,081	21,540,033	$0.04
Effect of common stock equivalents	—	2,712,685	
Diluted EPS	$908,081	24,252,718	$0.04

ZAGG INCORPORATED AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited)

	Net Income	Weighted Average Shares	Per Share Amount
Nine months ended September 30, 2010:			
Basic EPS	$6,561,208	22,375,468	$0.29
Effect of common stock equivalents	—	1,332,062	
Diluted EPS	$6,561,208	23,707,530	$0.28
Nine months ended September 30, 2009:			
Basic EPS	$3,130,585	20,630,819	$0.15
Effect of common stock equivalents	—	2,271,445	
Diluted EPS	$3,130,585	22,902,264	$0.14

The calculation above for the three months ended September 30, 2010 excludes the exercise of 350,000 outstanding warrants and 247,000 outstanding stock options as the exercise of these warrants and stock options would have an anti-dilutive effect on earnings per share. The calculation for the nine months ended September 30, 2010 excludes the exercise of 350,000 outstanding warrants and 1,007,833 outstanding stock options as the exercise of these warrants and stock options would have an anti-dilutive effect on earnings per share. The calculation above for the three and nine months ended September 30, 2009 excludes the exercise of 4,096,953 outstanding warrants and 3,000 outstanding stock options as the exercise of these stock options would have an anti-dilutive effect on earnings per share.

NOTE 2 – RECENT ACCOUNTING PRONOUNCEMENTS

Disclosures about Fair Value Measurements – In January 2010, the FASB issued guidance that requires an entity to disclose the following:

- Separately disclose the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe reasons for the transfers.

- Present separately information about purchases, sales, issuances and settlements, on a gross basis, rather than on one net number, in the reconciliation for fair value measurements using significant unobservable inputs (Level 3).

- Provide fair value measurement disclosures for each class of assets and liabilities.

- Provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for fair value measurements that fall in either Level 2 or level 3.

This guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010. The Company is currently evaluating this guidance and does not expect the adoption of this guidance to have a material effect on the Company.

ZAGG INCORPORATED AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE 3 – ACCOUNTS RECEIVABLE

Accounts receivable at September 30, 2010 and December 31, 2009 was as follows:

	September 30, 2010	December 31, 2009
Accounts receivable	$14,829,206	$6,135,877
Less: Allowance for doubtful accounts	(685,155)	(685,155)
Accounts receivable, net	$14,144,051	$5,450,722

Bad debt expense for the nine months ended September 30, 2010 and 2009 was $0 and $86,921, respectively.

On May 13, 2009, the Company entered into an accounts receivable financing agreement with Faunus Group International, Inc. (“FGI”). Under the agreement, the Company could offer to sell its accounts receivable to FGI each month during the term of the Agreement, up to a maximum amount outstanding at any time of $4,000,000. The Company could sell accounts receivable to FGI on either a credit approved or full recourse basis. Credit approved invoices were sold to FGI with no recourse, FGI accepted all credit default risk on invoices sold under the credit approved terms. The Company accounted for the sale of the credit approved invoices as a reduction to accounts receivable. Under the terms of the agreement, the Company was charged a monthly collateral management fee of 0.87% of the average monthly outstanding balance and interest at 7% per annum. The term of the agreement was for a period of four years, however, effective May 12, 2010, the Company terminated the receivable financing agreement with FGI. As a result of the early termination of the agreement, the Company paid a termination fee of $75,000 to FGI that was recorded as interest expense in the accompanying financial statements in full satisfaction of the Company’s obligations under the agreement.

NOTE 4 – INVENTORIES

At September 30, 2010 and December 31, 2009 inventories consisted of the following:

	September 30, 2010	December 31, 2009
Finished goods	$3,760,517	$778,871
Raw materials	7,029,446	2,991,394
Allowance for obsolete inventory	(400,037)	(74,425)
Total inventory	$10,389,926	$3,695,840

NOTE 5 – PROPERTY AND EQUIPMENT

At September 30, 2010 and December 31, 2009, property and equipment consisted of the following:

	Useful Lives	September 30,	December 31,

			2010		2009
Computer equipment and software	3 to 5 years	$	551,863	$	431,923
Equipment	3 to7 years		624,823		452,473
Furniture and fixtures	7 years		97,054		109,392
Automobiles	5 years		93,002		93,002
Leasehold improvements	1 to 2.75 years		444,190		318,180
Total property and equipment			1,810,932		1,404,970
Less: accumulated depreciation			(747,074)		(517,265)
Total property and equipment, net		$	1,063,858	$	887,705

Depreciation expense was $229,810 and $167,766 for the nine months ended September 30, 2010 and 2009, respectively.

ZAGG INCORPORATED AND SUBSIDIARY
Notes to Condensed Consolidated Financial Statements
(Unaudited)

NOTE 6 – INTANGIBLE ASSETS

At September 30, 2010, intangible assets consist of legal fees and expenses paid in connection with the Company’s patent applications of $47,040 and amounts paid to secure the Company’s Internet addresses of $99,270. The costs relating to the definite-lived intangible assets are amortized over their estimated useful lives using straight-line amortization. As of September 30, 2010, the patents had not been granted. Accordingly, the Company has not begun to amortize the patent costs and will begin am