

ZAGG INC AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except par value)

	<u>2012</u>	<u>2011</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 20,177	\$ 26,433
Accounts receivable, net of allowances of \$2,974 in 2012 and \$2,070 in 2011	54,561	45,450
Inventories	39,988	29,622
Prepaid expenses and other current assets	9,547	1,593
Deferred income tax assets	<u>6,912</u>	<u>5,132</u>
Total current assets	131,185	108,230
Investment in HzO	2,013	4,879
Property and equipment , net of accumulated depreciation at \$3,317 in 2012 and \$1,857 in 2011	4,862	4,162
Goodwill	1,484	6,925
Intangible assets , net of accumulated amortization at \$13,790 in 2012 and \$3,989 in 2011	57,905	73,691
Deferred income tax assets	6,596	82
Note receivable	583	1,349
Other assets	<u>1,457</u>	<u>3,010</u>
Total assets	<u>\$ 206,085</u>	<u>\$ 202,328</u>
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	\$ 19,027	\$ 16,013
Income taxes payable	3,062	4,294
Accrued liabilities	3,754	3,886
Accrued wages and wage related expenses	2,554	1,468
Deferred revenue	722	320
Current portion of note payable	6,000	2,372
Sales returns liability	<u>6,697</u>	<u>5,387</u>
Total current liabilities	41,816	33,740
Revolving line of credit	22,173	23,332
Noncurrent portion of note payable	<u>18,000</u>	<u>42,628</u>
Total liabilities	81,989	99,700
Stockholders' equity		
Common stock, \$0.001 par value; 100,000 shares authorized; 31,215 and 29,782 shares issued and outstanding, respectively	31	30
Additional paid-in capital	77,234	70,248
Cumulative translation adjustment	(57)	(33)
Note receivable collateralized by stock	(566)	(566)
Retained earnings	47,454	32,949
Total stockholders' equity	<u>124,096</u>	<u>102,628</u>
Noncontrolling interest	-	-
Total equity	124,096	102,628
Total liabilities and equity	<u>\$ 206,085</u>	<u>\$ 202,328</u>

ZAGG INC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	For the Years Ended December 31,		
	2012	2011	2010
Net sales	\$ 264,425	\$ 179,125	\$ 76,135
Cost of sales	<u>143,880</u>	<u>97,201</u>	<u>38,738</u>
Gross profit	<u>120,545</u>	<u>81,924</u>	<u>37,397</u>
Operating expenses:			
Advertising and marketing	12,495	10,246	5,067
Selling, general and administrative	53,330	39,592	15,504
Impairment of goodwill and intangibles	11,497	-	-
Amortization of definite-lived intangibles	<u>9,732</u>	<u>3,949</u>	<u>12</u>
Total operating expenses	<u>87,054</u>	<u>53,787</u>	<u>20,583</u>
Income from operations	33,491	28,137	16,814
Other income (expense):			
Interest expense	(6,321)	(3,022)	(243)
Loss from equity method investment in HzO	(2,866)	-	-
Gain on deconsolidation of HzO	-	1,906	-
Other income and (expense)	<u>(406)</u>	<u>(19)</u>	<u>7</u>
Total other expense	<u>(9,593)</u>	<u>(1,135)</u>	<u>(236)</u>
Income before provision for income taxes	<u>23,898</u>	<u>27,002</u>	<u>16,578</u>
Income tax provision	<u>(9,393)</u>	<u>(9,418)</u>	<u>(6,650)</u>
Net income	<u>14,505</u>	<u>17,584</u>	<u>9,928</u>
Net loss attributable to noncontrolling interest	-	664	35
Net income attributable to stockholders	<u>\$ 14,505</u>	<u>\$ 18,248</u>	<u>\$ 9,963</u>
Earnings per share attributable to stockholders:			
Basic earnings per share	<u>\$ 0.48</u>	<u>\$ 0.67</u>	<u>\$ 0.44</u>
Diluted earnings per share	<u>\$ 0.46</u>	<u>\$ 0.63</u>	<u>\$ 0.41</u>

See accompanying notes to consolidated financial statements.

ZAGG INC AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For the Years Ended December 31,		
	2012	2011	2010
Cash flows from operating activities			
Net income	\$ 14,505	\$ 17,584	\$ 9,928
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Stock-based compensation	5,707	3,258	994
Impairment of goodwill and intangibles	11,497	-	-
Excess tax benefits related to share-based payments	(707)	(1,670)	(620)
Depreciation and amortization	11,559	5,926	348
Deferred income taxes	(8,293)	(3,908)	(1,482)
Amortization of deferred loan costs	708	329	-
Write-off of deferred loan costs	1,509	-	-
Expense related to issuance of warrants	311	377	293
Expense related to issuance of stock for consulting	-	100	-
Expense related to issuance of stock for royalties	-	336	-
Impairment on notes receivable	-	1,489	-
Loss on disposal of property and equipment	313	-	-
Loss on investment in equity method investment	2,866	-	-
Gain on deconsolidation of HzO	-	(1,906)	-
Changes in operating assets and liabilities, net of acquisition			
Accounts receivable	(9,093)	(22,098)	(12,218)
Inventories	(10,334)	2,468	(14,251)
Related party other asset	-	-	(2,747)
Prepaid expenses and other current assets	(7,600)	1,607	(1,861)
Other assets	(11)	134	(54)
Accounts payable	3,044	42	9,341
Income taxes payable	(656)	(2,092)	6,802
Accrued liabilities	(262)	3,369	686
Accrued wages and wage related expenses	681	(953)	138
Deferred revenues	403	(72)	32
Sales return liability	1,299	2,811	1,517
Net cash provided by (used in) operating activities	<u>17,446</u>	<u>7,131</u>	<u>(3,154)</u>
Cash flows from investing activities			
Deposits on and purchase of intangible assets	(72)	(96)	(2,117)
Purchase of property and equipment	(2,764)	(1,590)	(819)
Deconsolidation of HzO, net of cash	-	(4,277)	-
Proceeds from investment in note receivable	-	496	-
Acquisition of iFrogz, net of cash acquired	-	(47,532)	-
Net cash used in investing activities	<u>(2,836)</u>	<u>(52,999)</u>	<u>(2,936)</u>
Cash flows from financing activities			
Payment of debt issuance costs	(238)	(2,538)	-
Proceeds from issuance of term note	24,000	45,000	-
Proceeds from revolving credit facilities	26,238	29,837	31
Payments on term note	(45,000)	-	-
Payments on revolving credit facilities	(27,396)	(11,546)	-
Proceeds from exercise of warrants and options	895	2,467	2,790
Excess tax benefits related to share-based payments	707	1,670	619
Cash paid for investment in HzO	-	(392)	-
Net HzO proceeds from issuance of Series B Preferred Stock	-	5,335	-
Net cash provided by (used in) financing activities	<u>(20,794)</u>	<u>69,833</u>	<u>3,440</u>
Effect of foreign currency exchange rates on cash and cash equivalents	(72)	95	52
Net increase (decrease) in cash and cash equivalents	(6,256)	24,060	(2,598)
Cash and cash equivalents at beginning of the period	<u>26,433</u>	<u>2,373</u>	<u>4,971</u>

ZAGG INC AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (EXCERPTS)
(Dollars, units, & shares in thousands, except per share data)

(7) GOODWILL & INTANGIBLE ASSETS*Impairment of Goodwill and Intangible Assets*

For the year ended December 31, 2012, the Company recorded an impairment of goodwill in the amount of \$5,441 for its iFrogz reporting unit within the iFrogz operating segment when it was determined that the carrying value of goodwill exceeded its fair value, which was determined during an impairment analysis performed during the fourth quarter of 2012. In conjunction with the impairment test, the Company considered factors such as the overall decline in the market price of the company's stock and decline in market capitalization for a sustained period as indicators for potential goodwill impairment. In determining the amount of impairment within the analysis, we considered both the income approach, utilizing a discounted cash flow analysis, and market approach, which considers what other purchasers and sellers in the market have paid for companies reasonably similar to the reporting unit.

The goodwill impairment of \$5,441 is included as a component of impairment of goodwill and intangibles in the consolidated statement of operations.

The changes in the carrying amount of goodwill for the year ended December 31, 2012 and 2011, are as follows:

	2012	2011
Balance as of January 1		
Gross goodwill	\$ 6,925	\$ —
Accumulated impairment losses	—	—
Net goodwill as of January 1	6,925	—
Goodwill acquired during the year	—	6,925
Impairment loss	(5,441)	—
Balance as of December 31		
Gross goodwill	6,925	6,925
Accumulated impairment losses	(5,441)	—
Net goodwill as of December 31	\$ 1,484	\$ 6,925

(8) INCOME TAXES

The components of income tax (provision) benefit for the years ended December 31, 2012, 2011 and 2010, are:

	2012	2011	2010
Current (provision):			
Federal	\$ (15,466)	\$ (11,487)	\$ (7,058)
State	(2,104)	(1,767)	(1,074)
Foreign	(116)	(72)	—
Total current	(17,686)	(13,326)	(8,132)
Deferred (provision) benefit:			
Federal	7,209	3,402	1,283
State	1,084	506	199
Total deferred	8,293	3,908	1,482
Total (provision) benefit	\$ (9,393)	\$ (9,418)	\$ (6,650)

The following is a reconciliation of the income taxes computed using the federal statutory rate to the provision for income taxes for the years ended December 31, 2012, 2011 and 2010:

	2012	2011	2010
Tax at statutory rate (35%)	\$ (8,364)	\$ (9,451)	\$ (5,636)
State tax, net of federal tax benefit	(663)	(888)	(556)
Gain on deconsolidation of HzO	—	316	—
Non-deductible expense and other	(341)	(130)	(198)
Domestic production activities deduction	676	771	587
Return to provision adjustment	(49)	(36)	(437)
Interest and penalties	—	—	(201)
Federal 38% rate bracket surcharge	—	—	(209)
Increase in valuation allowance	(652)	—	—
	\$ (9,393)	\$ (9,418)	\$ (6,650)

The tax effects of temporary differences that gave rise to significant portions of deferred tax assets and liabilities at December 31, 2012 and 2011, are as follows:

	2012	2011
Deferred tax assets:		
Allowance for doubtful accounts	\$ 1,020	\$ 791
Deferred revenue	27	12
Inventories	2,317	1,636
Stock-based compensation	1,420	597
Sales returns accrual	2,456	2,061
Acquisition costs, net of amortization	282	292
Intangible assets	4,372	307
Goodwill	1,801	—
HzO investment	713	—
Reserve on note receivable	569	569
Other liabilities	38	35
Deferred tax assets	15,015	6,300
Valuation allowance	(713)	—
Total deferred tax assets	<u>\$ 14,302</u>	<u>\$ 6,300</u>
Deferred tax liabilities:		
Property and equipment	794	633
Investment in HzO	—	384
Goodwill	—	69
Total gross deferred tax liabilities	794	1,086
Net deferred tax assets	<u>\$ 13,508</u>	<u>\$ 5,214</u>
Deferred tax assets, net – current	\$ 6,912	\$ 5,132
Deferred tax assets, net – noncurrent	6,596	82
Net deferred tax assets	<u>\$ 13,508</u>	<u>\$ 5,214</u>

At December 31, 2012, the Company recorded a full valuation allowance against a deferred tax asset generated by losses on its equity method investment in HzO. HzO is a development stage enterprise and given current operations and uncertainty of future profitability, management has determined that it is more likely than not that the deferred tax asset will not be realizable. Given this, a full valuation allowance of \$713 has been recorded against the deferred tax asset.

The Company has not recorded a tax benefit at December 31, 2012 and 2011 for operating losses in France and the UK from operations of iFrogz Europe SAS (gross cumulative operating loss of \$1,280). Operations for iFrogz Europe and ZAGG Europe have been transitioned to Ireland and therefore, we do not expect future taxable income within France and the UK to offset current net operating losses.

For all other deferred tax assets, no valuation allowance has been recorded at December 31, 2012 and 2011, as management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize its deferred tax assets.

The Company has not recognized a deferred tax liability for the undistributed earnings of its foreign operations that arose in 2012 and prior years as the Company considers these earnings to be indefinitely reinvested. Cash held by foreign entities that is considered permanently re-invested totaled \$3,531 as of December 31, 2012. If this cash were repatriated to the United States, outside the settlement of intercompany payables, the Company would need to accrue and pay the related tax, however, the Company considers these funds permanently re-invested and has no plans to repatriate these funds.

The Company recognizes the impact of a tax position in the financial statements if that position is more likely than not of being sustained on audit, based on the technical merits of the position. As of December 31, 2012 and 2011, the Company recorded a tax contingency of \$61 and \$61, respectively, related to foreign taxes at the iFrogz segment. For the years ended December 31, 2012, 2011, and 2010, the Company recorded \$0, \$0, and \$201, respectively in interest and penalties, which were included as a component of income tax provision.

The Company is currently not under examination by any federal or state tax authority, but remains subject to income tax examinations for each of its open tax years, which extend back to 2009 for federal income tax purposes and 2008 for state income tax purposes.